A Guide on
Value Added Tax

மதிப்பு கூட்டல் வரி - கையேடு

Published by

CODISSIA

The Coimbatore District Small Industries Association

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A Guide on Value Added Tax

CODISSIA's Guide on Value Added Tax both in English and Tamil is published by Coimbatore District Small Industries Association to equip their member industries to get first hand knowledge about Value Added Tax (VAT). The book is constructed in a way that industry and trade should know the concepts, issues and procedures and plan their activity to smooth transition to VAT.

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Caution

While every effort is made to ensure accuracy of the texts on Value Added Tax, the guide cannot be taken as official legal the interpretation of the Act. In addition simplifications are used to make the text simple and clear. It does not substitute reading the Model VAT Bill 2003 or Tamil Nadu Value Added Tax Act, 2003 or any other similar Acts or Rules. Further the view expressed in the Guide about Value Added tax are purely of the author and are not expression of CODISSIA.

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Small business plays a vital role in the economic growth of any Country. Consequently most Asian developing Countries have adopted promotion programs for the Small Business sector. In the past, support would flow mainly through Govt. programs.

The ZDH Partnership Program pursues a new approach by encouraging greater involvement of private sector institutions like federations, chambers and associations in small business development. It is convinced that a joint effort by both Government and Private Sector institutions will accelerate the growth prospects and performance of the small business sector.

Currently, SEQUA administers the program in China, India, Vietnam and Nepal. In these 4 Countries, SEQUA is working with federations, Chambers and Small Industry Associations in areas of institutional building, export promotion consultancy, training for SME sectors, etc.

In India, ZDH / SEQUA operates in partnership with chambers and associations in the States of Tamil Nadu, Andhra Pradesh and Karnataka. In this context, ZDH / SEQUA is pleased to partner with CODISSIA in publishing this information booklet on Value Added Tax -VAT. We are very sure that this publication will be of immense use to the SSI sector and small traders in Tamilnadu.

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GREETINGS

The Guide on Value Added Tax published by CODISSIA both in English and Tamil contains excellent utility oriented inputs needed for trade and industry. All issues that would arise during the implementation of VAT are profoundly gone into and vividly explained for the benefit of the users.

This valuable Guide will be of meaningful use to all sections directly or indirectly connected to VAT Regime.

(C. PONNAIYAN)

To
Thiru. Tee. Narayanaswami
President,
CODISSIA,
Coimbatore.

“அம்மா”

“அம்மா”

PREFACE

SWITCHING over to value-added tax is important to Tamil Nadu for growth and competitiveness. For a State that is not so rich in natural resources like perennial rivers, efficiency should be the watchword to compete with resource-rich States according to Dr Raja Chelliah, Chairman, Madras School of Economics. With the taxes focussed on the consumption end and exemptions few, they are bound to be proportional to consumption, and in co-ordination with a moderately progressive income the system could be efficient.

There may be some hitches like co-existence of CST, Entry Tax etc. for some period preventing the system to reap the full benefits of VAT. But subsequently they may be phased out we hope. Anyhow one day VAT will be in place in its full form. Hence it is wise to know thoroughly about the VAT. Having this in mind CODISSIA has decided to bring out a GUIDE both in TAMIL and ENGLISH for the benefit of the entire business community. We have received all encouragements from Government of Tamil Nadu and other sister associations and our members.

Mr.D.Gandhikumar, our Past President who compiled this guide has taken lot of efforts in collecting information, verifying the same for its correctness and finally succeeded in giving the present shape.

At this juncture, it is our duty to thank Thiru C. Ponnaiyan, Hon'ble Minister for Finance and Thiru S.M.Velusamy, Hon'ble Minister for Commercial Tax, Government of Tamil Nadu for their encouragement and valuable greetings for this publication.

We thank Mr.N.Somasundaram Dy.Commissioner(Enforcement) and Dr.A.Rajaraman Dy. Commissioner (Admn.) of Commercial Tax Department, Coimbatore for all their supports and assistance.

We wish to put our appreciation and thanks on record for Mr. Ravichandran for the meticulous work of preparing the Tamil version.

We thank TALLY, Advent Systems, Khaay-Zen Equipments and NSIC for their support in bringing out the book.

We put on record our appreciation and heartfelf thanks to ACE DATA for the fine printing job which adds value to the book.

Finally our heartfelt thanks to the team of ZDH / SEQUA Partnership programme, Germany who have sponsored the project.

We hope this publication will create an awareness among the business community and will be helpful in throwing light on VAT.

-- CODISSIA

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Chapter - 1

Introduction

Tax reforms in India was initiated as a part of the economic reforms in 1991. The taxation reforms have been initiated on the basis of the tax reforms Committee report. In the first generation fiscal (taxation) reforms, the taxes at the central level were reformed. In the case of direct taxes, the objectives of the reforms were to expand the direct tax base, reduce the rates and reducing the procedures for better resource mobilization.

In the case of indirect taxes the average custom duties have been reduced to 40% and is expected to be 35% for all commodities by 2005. With regard to Central Excise the number of rates have been reduced to 40% and is expected to be 35% for all commodities by 2005. With regard to Central Excise the number of rates have been reduced and the has brought under VAT (CENVAT) with a single rate. These reforms have certainly increased the revenue to the centre and increased the compliance by the industry.

As a part of the second generation fiscal (taxation) reforms the Government of India has proposed the reforms in the state level taxes especially the sales tax.

The recent evolution of VAT can be considered as the most important fiscal innovation of the present century.

VAT is a multi-point Sales Tax with set-off for tax paid on purchases. It is collected in installments at each transaction in the production distribution system. It does not have cascading effect due to the system of deduction or credit mechanism.

It is a tax on consumption. The final and total burden of the tax is fully and exclusively borne by the domestic consumer of goods and services. It is being a tax on domestic consumption, no VAT is charged on goods exported. It is an alternative mechanism of collection of tax. In many respects it is equivalent to a last point retail sales tax. Value Added Tax is, therefore, a multi-stage sales tax levied as a proportion of Value Added (i.e. sales minus purchase, which is equivalent to wages plus profits). The VAT is collected at each stage of production and distribution process and, in principle, its burden falls on final consumer only. Thus, it is a broad-based tax covering the value added of each commodity by a firm during all stages of production and distribution.

At present the sales tax is a single point levy, either focusing of the first sale by the manufacturer/importer or the last purchase by the manufacturer or the exporter within the state. This has advantage of identifying the tax payer who is usually the manufacturer or the importer within the state.

Traders had preferred single point scheme so that they may deal in tax paid exempt goods, and have much less to do with the tax officials.

Levy of Sales tax being a state subject, we have at present different procedures and practices in the States, multiplicity of rate of taxes, rate war amongst different states, different types of incentives and deferral schemes. With differing tax structure between states there was unhealthy diversion of trade between neighboring states. The rate anomalies between states have to some extent been eliminated with the implementation of Uniform Sales Tax Floor Rates.

A major disadvantage attributed to the present system of taxation is that is cascading and therefore the tax embedded in the finished product makes the industry uncompetitive i.e. in the case of manufacturer, the various raw materials and inputs and capital goods are subject to tax. The final product of a manufacturer is again levied with tax.

The main task of a system of taxation that would enable the government to reach the income and consumption of individuals without causing any, or more than the minimum possible, adverse effect on economy. At the same time, the system should be made equitable in the sense that equals will pay equal sum of tax and unequal will pay unequal sums with the better off individuals paying more and the worse off paying less.

Under VAT since tax paid on raw materials and other inputs will be allowed to be set off against the tax payable on the finished goods there will be no cascading of taxes.

In India sales tax is levied both by Central and State Governments. Besides sales Tax, taxes like Entry tax, octroi, luxury tax etc also by various state governments.

Some of the perceived problem in the VAT implementation are lack of proper business plan for its implantation, threat of fall in revenue to the state which are implementing it, lack of clarity on the treatment of interstate sales in the VAT, role of CST at the manufacturing after the implementation of VAT, treatment of services, declared goods works contract, threshold in all the states and changes in accounting procedures.

VAT as a single tax system covering all indirect levies by the State and Central Government is a wishful thinking and the attempt should be to at least integrate in the proposed state VAT all indirect taxes levied by the State Governments.

Where India is concerned, it has also become necessary to introduce VAT in order to broaden the nation's tax base and generate the revenue required for national development. Since VAT relieves investment from the burden of taxation, this tax is considered the most neutral and efficient. Export can be relieved from the burden of taxation through zero-rating, meaning that Indian-manufactured goods would become more competitive in the international market. Further, as VAT would help broaden the tax base, it would be feasible to reduce the rate of income tax and customs duties further. This would reduce the cost of taxation to the economy. Thus, VAT would have a positive impact on the economy.

Over the last few years, the pace of liberalisation of the Indian economy has speeded up. In fact, with export and import norms being relaxed, rupee convertibility on capital accounts closer than ever and the rapid growth of e-commerce, our economy is more outward looking today than ever before. One immediate effect of this environment, however, is greater competition for domestic manufacturers and traders. It is to help counteract this effect that the government has decided to introduce a Value-Added Tax (VAT) regime.

The Manufacturing Perspective

From a manufacturing perspective, VAT is a multi-point tax on each entity in the supply chain where input tax paid by the manufacturer on the purchase of raw materials is set off against the sale of the processed goods. India has opted for a two-tier VAT system where VAT will ultimately replace the sales tax currently imposed at the state level. There is no consensus yet on whether to abolish or make VATable other state levies like toll tax, entry tax, octroi etc. Thus, while Maharashtra has agreed to abolish turnover tax once VAT is implemented, it has yet to reach a decision on octroi. Only Central Sales Tax (CST), an origin-based tax on the inter-state sale of goods with revenue accruing to the state that exports goods, will be phased out. As of now, a four-year time frame is being finalised for the phasing out of this tax, beginning financial year 2003-04. CST will remain undisturbed for the remainder of 2002-03.

The Centre has also agreed to compensate the states for the revenue loss engendered by VAT. This compensation will be 100 per cent for the first year, 75 per cent in the second year and 50 per cent in the third year.

States will also be permitted to impose sales tax on sugar, textiles and tobacco from June 2003 at a uniform rate of one per cent. To facilitate this, the Centre has agreed to amend legislation on additional excise duties on special goods. Eight states and all the union territories have already sent in their proposals and the draft laws of Maharashtra, Madhya Pradesh and Chattisgarh have been cleared.

One major factor stifling the growth of manufacturing in India has been the high fiscal burden in the form of state and central levies. In many cases, these taxes constitute nearly half the selling price of the product, an untenable proposition for companies competing in the global market. Such levies, in tandem with poor infrastructure and high financial costs, cripple the employment generation potential of Indian manufacturing, making it non-viable.

VAT will hopefully rectify the situation. Companies will be able to make business decisions on the basis off economic considerations other than tax benefits. VAT will also encourage companies to optimise their operations by adopting methods like JIT or completely outsourcing functions like logistics. The frequency of visits to courts will also decrease.

The ideal system, of course, would be a single national VAT as in China. But, given our federal polity, a system modelled on the VAT regime currently in use in the European Union offers the best alternative. The important thing at this critical juncture is to make sure we do not lose sight of the ultimate goal of a VAT system - a common markets within the country. Losing sight of this could well mean a 'billion mutinies' in the most populous country in the world.

Chapter - 2

Principles of VAT

Before to explain the meaning and characteristics of VAT and to indicate why it is to be preferred to sales taxes levied on the gross sale value of commodities, it would be useful to define value added and show how it can be measured.

The gross output of goods and services produced in a country is measured in terms of the total value of all the commodities and services, when they reach the hands of the final users, namely, consumers and investors (buyers of capital goods), after going through various stages of production, plus the value of exports. This measure of total output for a year is termed gross domestic product for the year and represents the sum of all values of goods and services produced in the country during the year. Now typically, each commodity passes through several stages of production and at each stage some value is created or added. The total value of a commodity as it reaches the hands of the final user is the sum of values created at the successive stages of production. The value added at each stage of production can be worked out (quantitatively) from the production account of the concerned enterprise or producing unit. That account for a year can be presented in the following way (in summary terms):

Receipts	Rs.	Expenditure	Rs.
Income from sale of output (= gross value of output)	10,000	Cost of bought out inputs	4,000
		Wages and salaries	2,000
		Rent	1,500
		Interest	500
		Depreciation	1,000
		Surplus	1,000
	10,000		10,000

Gross Value = Rs.10,000
Gross Value added = gross value of output – cost of bought out inputs
= Rs.10,000 – Rs.4,000 = Rs.6,000

(It is assumed that there is no change in inventories)

It may be noted that gross value added is equal to the sum of wages and salaries, rent, interest, depreciation and profits (net Value Added will exclude depreciation)

Under VAT, the value added at each stage of production and distribution is taxed. Since the sum of value added at the different stages of production is equal to the total value embodied in a commodity, the VAT on a commodity amounts to a tax on just the total value of that commodity. By contract, a sales tax on the total value of out put or turnover falls on the value of inputs at successive stages unless the tax is confined to retail sales. Even the first point sales tax levied by most state governments has a base that includes the cost of current and capital inputs at successive stages of manufacturing. As has already been indicated, this results in cascading of tax burden and escalation of costs. Hence the need to adopt VAT, though it is necessarily a multi point tax.

Value Added Tax is neither a new tax not a kind of tax, but it is a method of taxation under Sales Tax System. There are various methods of taxation like, single point, multi point, dual point, last point and retail tax in the present sales tax system. Similarly Value Added Tax is also a method of taxation under Sales Tax. It captures tax chain of transaction. In this system of taxation, tax paid or payable on purchase is collected at different stages in installments in chain of sales from manufacture to retailer with provision to rebate / deduct the tax paid on purchases.

VAT is one of species of sales tax. Therefore, it is an indirect tax. As VAT is imposed on commodities, it is also called commodity tax. It is stated that it is latest refinement of various conventional types of commodity taxes levied on production, sales turnover. Important characters VAT are (1) VAT system prevents the cascading of taxes (2) It promotes exports (3) It is neutral in its impact on the economy (4) VAT activity promotes efficiency, simplicity and equity and is intrinsically transparent.

VAT – is a modern tax concept which is talked much, discussed much and implemented at large. Its root was seen in 1920 and came to existence in 1948. Its wide spread is felt in 1990s. Like an octopus, it captured today about 120 countries. Its rapid spread is admired with wonder by Alan A Tail in the following lines:

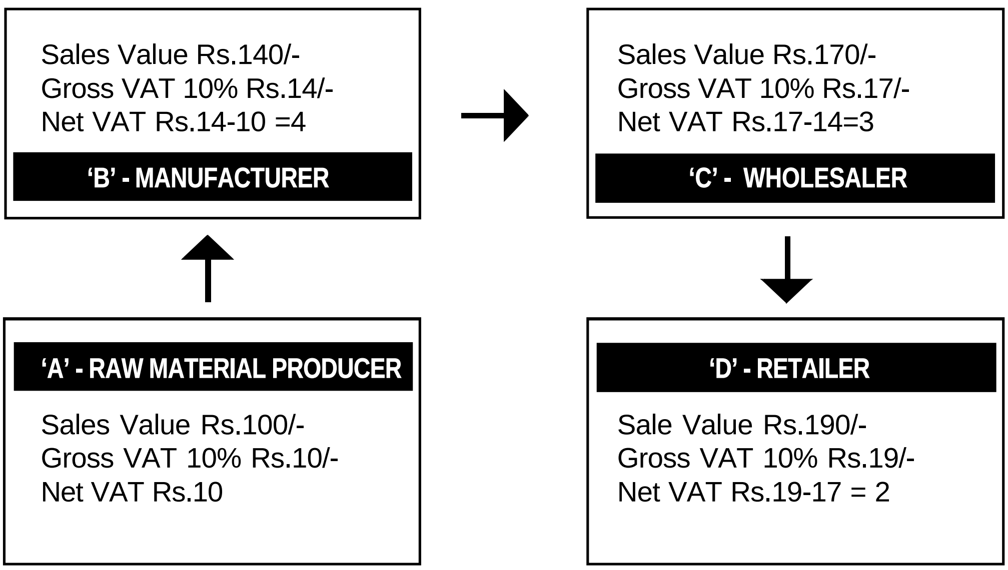
“The rise of Vale Added Tax (VAT) is unparalleled tax phenomenon. The history of taxation reveals no other tax that has swept the world in some thirty years, from theory to practice and has carried along with it academics whoever once dismissive and the countries once rejected it. It is no longer a tax associated with European Community (EC). Every continent now uses VAT and each year sees new countries introducing VAT. VAT may be thought of as “Maha Hari” – of tax world – many are tempted, many succumb, many tremble on the limit while others leave only to return, eventually attraction appears irresistible”

He explains that Value Added is the value that a producer (whether a manufacturer, distributor, advertising agent, hair dresser, farmer, race horse trainer or circus owner) adds to his raw materials, or purchases (other than labour) before selling the new or improved product or service. That is, the inputs (the raw materials, transport, rent, advertising and so on) are brought, people are paid wages to work on these inputs and when final goods or service is sold some profit is left.

As the term indicates, it is a tax imposed on Value Addition of the goods in the chain of transaction from production, distribution and retail. A full-fledged VAT is in essence an advalorem tax on domestic final consumption levied at all stages between production and final point of sale. At each stage, the tax is confined only to value added. So, VAT is a tax not on the total value of the goods being sold but only on the value added to it by the seller. The seller therefore, is liable to pay tax not on its gross value but on the net value, (i.e.) the gross value minus the value of input. It is a multi-stage tax collected at different stages in the chain of transaction of goods. Thus, by this imposition the tax is being collected in installment. Therefore, VAT may be called as modified multi-point sales tax. There is no cascading effect in this system as no tax is levied on tax.

VAT, being a multi-point tax, provided a number of opportunities to the Government to gain access to the revenue. It is, therefore, sometimes called as money machine to the Government. The tax collect on value added is equated to wages interest, other cost and profit.

The imposition of tax under the VAT may be illustrated as under:



Note : Total VAT collected at four points. Rs.10+4+3+2=Rs.19/-

The tax paid on purchases is called input tax; and tax payable on sales is called output tax. The difference between output tax and input tax is VAT excess, as the case may be. There is link between tax paid on purchases and tax collected on sales. This link is called VAT chain.

The distinct difference between VAT and Sales Tax is in determination of tax liability. In Value Added Tax System the tax liability is split and collected in bits at each stage of production, distribution and retail sale but in Sales Tax System, at present, the tax is collected either at first stage or last stage and sometime at both stages. The difference may be summarized as follows.

Manufacturer's VAT:

This form of VAT is restricted only upto manufacturing stage. This is also called MANVAT. The nature and concept of manufacturing VAT was explained by the Indirect Taxation Enquiry Committee 1977 in the following passage:

"The main advantage of MAN VAT would be that it would altogether eliminate cascading on account of taxation of raw materials and other inputs. The tax levied on a final product would be the total tax on it and the tax on input at earlier stages will not affect its cost or price. The consequent reduction in interest charges and in successive mark-ups would also be favourable factors as far as prices of final products are concerned. The community would know the real tax burden on each product and it would also facilitate the gradation of different products under lower or higher rates in order to achieve the desired degree of progression. MANVAT may also minimize the requirement of physical checks

Sl.No.	SALES TAX	VALUE ADDED TAX
1.	Tax is levied either at multi-stage or single stage.	The comprehensive VAT tax is levied at every point of sale till retail stage.
2.	Tax is imposed only on sales turn over of goods.	Tax is levied on every value addition including services, agricultural activities, labour, interest, royalties etc. (in comprehensive VAT system).
3.	Tax paid on purchase is not rebated	Tax paid on purchases (inputs) including capital goods is rebated.
4.	As tax paid is built in the cost, it taxes the tax. So there is tax cascading.	As tax paid is fully rebated, there is no cascading.
5.	In order to minimize cost of production, the manufacturer is in habit of manufacturing intermediary products to use in this final product (otherwise they could purchase from other industry). This leads to vertical integration.	As the tax paid is credited, there is not possibility of vertical integration.
6.	Due to this tax system there is always abnormal increase in price of the goods.	This system contains price increase. However it is stated that if there is increase in price, it is very nominal, bearable.
7.	In single point tax, verification of anterior sufferance of tax is not easy. So there is large scale evasion.	The system facilitates mechanism for verification of claim of tax credit.

A tax structure of any country is based on three categories (1) coverage (2) tax nature (3) its legal basis and basis of turnover. The coverage of any taxation depends upon the needs of economy. On the basis of coverage, the VAT may be classified into three forms namely, (1) manufacturer's of VAT, (2) Whole sale VAT and (3) Retail VAT.

On the basis of coverage

Manufacturer's VAT (MANVAT) — Whole sale VAT (W-VAT) — Retail VAT (R-VAT)

to ensure that there is not much evasion. Besides, the competitiveness of our products in the export markets will get a major thrust".

From the administrative angle, MANVAT should not present insurmountable difficulties. From the point of view of accounting, the larger manufacturers would not find it too difficult to cope with the requirements of VAT and the number of taxpayers to be dealt with would be manageable.

Whole Sale VAT

Wholesale VAT is also not full-fledged VAT. It also creates problems. All involve a much smaller tax base than one which includes retail sales and, therefore, the tax rates must be higher to yield an equivalent revenue. VAT at the wholesale level must define a wholesale price because traders often combine manufacturing and wholesale activities as well as wholesale and retailing activities. This leads to a complex set of rules or regulations defining "up lifts" from factory gate prices or establishing standard discounts on retail prices. A VAT, through the wholesale stage should only be considered as a temporary interim arrangement on the way to extending the VAT fully to the retail stage. It is doubtful whether the inefficiencies for both taxpayer and administration ever make it worthwhile other than as a temporary arrangement.

Retail VAT :

In Retail VAT the tax is levied at the last stage of transaction. It covers the entire Value Added on the goods. It covers a large number of assesses and therefore, difficult to administrator. It is therefore, stated that only a comprehensive Value Added Tax Act which will cover all activities including agricultural activities and services from manufacturing to retail Stage is best for implementation.

The difference between full fledged VAT and retail tax is enlisted as tabulated below:

Commodity tax is levied on two principles :

1) Principle of origin and (2) Principle of destination

Origin Principle :

Under origin principle, tax on goods and services is levied on the basis of origin of goods. The place where the goods are originated is situs of sale of place of sale.

Sl.No.	VAT	Retail Tax.
1.	Tax is levied at every stage after deducting tax paid on purchases	Tax is levied at last stage of series of transaction. Only last dealer (retailer) shall pay tax.
2.	As it multi stage tax, every dealer has to pay tax.	
3.	Only a small part of tax is collected from dealers as lower end of chain. So evasion is minimum.	Entire tax is to be paid by the retailer. So there is possibility of large evasion.
4.	Cross check is easier if the dealer in chain does not pay tax, dealer is subjected to full tax.	Cross check is not administratively possible. If tax is lost at retail stage, the loss is permanent.
5.	The administration needs to concentrate attention mainly on big dealers. So this is administratively easier.	It is administratively difficult to concentrate attention on all small dealers who are large in numbers.

Central Sales Tax is typical illustration for this principle. Under Central Sales Tax Act, 1956, the place from where the goods move to other State with privity of contract is the situs of sale. Thus, in origin principles, the tax is levied on origin of goods. So, under this principle export is taxed, while import is exempt. The origin principle indirectly given importance to the goods manufactured abroad. This method is used in connection with income VAT (I-VAT). The EEC countries adopted and followed origin principle in their Tax System but subsequently shifted to destination principle.

Destination Principle :

In destination principle, tax is levied irrespective of its origin. In other words, all the goods which are consumed domestically are subjected to tax. General Sales Tax is an illustration. The imports are taxed, while exports are exempt. Thus, in this principle goods manufactured domestically and goods imported are treated equally. This method is used in connection with Consumption VAT (C-VAT). Most of the countries which introduced VAT, follow this principle.

Variant of VAT : (Types of VAT)

For better tax compliance and tax administration, it is always desirable to have wider tax base. Tax base depends upon various factors, such as number of rate of tax, sectors and persons to be taxed, number of exemption, zero rate etc. It is desirable to keep rate of tax as low as possible with minimum range of tax and few exemption. On the basis of tax base, the VAT is classified into three variant types, namely:

(1) Gross Product VAT or P VAT

(2) Income VAT or I VAT

(3) Consumption VAT or C VAT

These variants are generally distinguished according to method of calculation in determining VAT liability. The different variants are explained as follows:-

Gross Product Variant (P-VAT)

In this variant, taxes paid or payable on all purchases including raw materials, components but excluding capital goods are deductable. Thus, tax on plant and machinery is not deductible at the time of purchase and subsequently tax on depreciated part of plant and machinery is also not deductible. So, the economic base of gross product variant is equivalent to Gross National Product. In this variant, as no deduction of tax or purchase or capital goods is allowed, there is every possibility of delay in modernization and upgrading plant and machinery. This discourage industrial growth of the country. At the time of purchase, tax is charged on capital goods and product sold are again taxed. Thus, capital investment is taxed twice in this type of VAT. This variant paves way for evasion. The main defect of this system is the discriminatory treatment given to capital goods. The value added under this variant will normally far exceed the year's sale. France employed this gross product VAT during 1936-1953. Finland, Morrocco and Senegal impose modified version of this variant. Senegal has restricted this to manufacturer's stage.

Income Variant VAT (I-VAT)

This type of VAT allows deduction of tax paid on purchase of raw materials, components as well as depreciation on capital goods. In other words, while it allows input tax credit for all purchases, it does not allow deduction of tax paid on capital goods but only to its depreciation. The method of arriving depreciation depends on economic factors available at particular time, and therefore there is no standard formula to arrive at the depreciation. For this reason, this is not favoured and advised. But few countries like Argentina, Peru and State of Michigan in USA are using this variant.

Consumption Variant (C-VAT)

In this type of VAT, tax paid on purchase of all business inputs is deducted from tax payable on sale. The tax

Types of VAT

Gross Product Variant	Income Variant	Consumption Variant
Tax levied on all sales with no deduction for capital inputs	Tax levied on all sales with set-off for depreciation on capital goods	Tax levied on all sales with deduction for all business inputs

paid on purchase of raw materials, trading goods, components, tools, fixtures, plant and machinery, computer furniture, and other office equipments, stationery, etc is VATable. So, gross investment is deductible in calculating value addition.

The economic base of tax is equivalent to total private consumption. This type of VAT does not discriminate capital assets and other business inputs. This can be extended to Value Addition at wholesaling or retailing points. The previous stages of production and transaction. This is very population in almost all countries which adopted VAT. This is closely in harmony with destination principle based tax system.

The merits of consumption type – VAT

1) This is easy to administer which simplifies tax administration
2) It is totally neutral to various methods of production as it does not effect decisions regarding investment because the tax on capital goods is totally rebated.
3) It does not discriminate capital goods and other goods.
4) It exempts exports, while import is taxed.
5) It is easy to compute tax liability (subtract tax paid on purchase from tax collected on sales)

Chapter - 3

Computation of VAT

There are many models to calculate and fix Value Added Tax liability. Among them there are two important methods.

Methods of computation of tax liability

- Additions method
- Subtraction method
  - Direct subtraction
  - Indirect subtraction

- **The subtraction method:** The tax rate is applied to the difference between the Value of output and the cost of inputs
- **The addition method:** The Value Added Tax is computed by adding all the payments to the factors of production, viz., wages, rent, interest and profits (as will be shown later, this method can be used only with the "income variant" of VAT)

In implementing VAT, most countries use an amended form of the subtraction method. The subtraction method of applying VAT may be described as

$$VAT = t(O-I)$$

Where t is the tax rate, O is the value of output and I is the Value of inputs. Now t(O-I) can be re-written as (tO-tI). That is, VAT can be collected as the difference between the tax payable on output and the tax paid on inputs. This method of computing and collecting VAT is called the input tax credit method. We shall discuss here only the subtraction method and the input tax credit method.

In a VAT, while the tax is levied and collected at every stage of production and distribution, it is to be ultimately borne by the final user of the good. This implies that tax inclusive price at any stage has to include taxes collected at all earlier stages. The input tax credit method achieves this by requiring the seller to collect tax on the entire value of output and retain the amount equivalent to the tax paid on purchases. However, in the subtraction method, at any stage, the tax is to be collected only on the value added at the stage. The taxes paid at the earlier stages would have to be a part of the cost of inputs, and the final price quoted by the seller would be a tax inclusive price. The tax due at any stage is computed by using a formula as shown in table (in page 10)

Both forms of computing the tax yield identical results under a regime of a single tax rate. However, in a multiple tax rate regime, the effective tax on any commodity could differ depending on the method used. The table in page 10 provides an illusteration.

The effective tax rate under the subtraction method is the weighted average of the rates at the different stages of transaction, the weights being the proportion of value added in each transaction. On the other hand, the effective tax rate under the input tax credit method is equal to the rate at the last transaction point. The point to note from this illustration is that the input tax credit method (referred to as ITC here on) provides a *transparent* method, whereby the effective tax rate on any commodity is easily identifiable as the rate applicable to the last transaction in that commodity. This makes the ITC method superior to the other method.

In addition to the loss of transparency under the subtraction method, since the effective rate of tax under this method is a weighted average of the rates at various stages, there could exist an incentive to shift value added to the stages with the lower tax rate. This kind of tax-induced distortion should be avoided to the extent possible. Thus, the ITC method is superior to the other method on the above ground as well, particularly when there are more than one rate.

Table : Computing VAT by two methods with a uniform tax rate of 10 per cent

	raw materials supplier	manufacturer	wholesaler	retailer	total economy
The economy					
Purchases	100	350	850		
Value added	100	250	500	250	1100
Sales	100	350	850	1100	
Input tax credit method					
i. Sales	100	350	850	1100	2400
ii. Taxes Collected	10	35	85	110	240
iii. Purchases	0	100	350	850	1100
iv. Taxes paid	0	10	35	85	130
VAT(ii-iv)	10	25	50	25	110
Price of the good	=100+10 **=110**	=350+35 **=385**	=850+85 **=935**	=1100+110 **=1210**	
Subtraction method					
i. Sales	110	385	935	1210	
ii. Purchases		110	385	935	
Calculation of tax	=(110-0)*0.1 / (1.1)	=(385-110)*0.1 / (1.1)	=(935-385)*(0.1) / (1.1)	=(1235-935)*(0.1) / (1.1)	
Tax due	10	25	50	25	110

* This is true provided Value Added is not computed as a mark-up on costs. If the latter method of arriving at Value Added is used , the substraction method would reintroduce cascading into the system of taxation.

Table : Wholesaling stage is subject to a 15 percent tax and rest to a 10 percent tax

	raw materials supplier	manufacturer	wholesaler	retailer	total economy	Effective rate of tax
The economy						
Purchases		100	350	850		
Value added	100	250	500	250	1100	
Sales	100	350	850	1100		
Input tax credit method						
i. Sales	100	350	850	1100	2400	
ii. Taxes Collected	10	35	127.5	110	240	
iii. Purchases	0	100	350	850	1100	
iv. Taxes paid	0	10	35	127.5	130	
VAT(ii-iv)	10	25	92.5	-17.5	110	10%
Subtraction method						
i. Sales	100	385	960	1235		
ii. Purchases		110	385	960		
Calculation of tax	=(110-0)*0.1 / (1.1)	=(385-110)*0.1 / (1.1)	=(960-385)* .15 / (1.15)	=(1235-935)*(0.1) / (1.1)		
Tax due	10	25	50	25	135	12.3%

Addition method

In this method a Value Added at each stage is calculated by adding up wages, Interest, depreciation, net profit and other payments. This method is generally employed in Income type VAT. This does not accommodate exemptions of intermediate dealers. It is not suitable to exempt export. So it is not suitable for the consumption VAT (C-VAT). It is difficult to adopt this type, when different type of transactions are in business activity. For example, a firm employes its labour to manufacture capital goods for its own use. The wages paid to such labour cannot be added to Value of the goods manufactured partly by labours. Here, wage bill has to be split into two viz. wages paid to labour who were employeed to manufacture capital goods and trading products.

Illustration No.1

		Tax at 10%
Wages paid	Rs.100/-	
Interest paid	Rs. 25/-	
Profit	Rs. 15/-	
VAT Base	Rs.140/-	

Thus this method is based on accounts maintained by the dealer in the course of his business. It is therefore called as accounts method. This method for calculating the VAT liability of a dealer cannot be used for a destination base consumption type of VAT because of difficulties in identifying tax payments for exports and imports and complexities in consumption of profits for income tax purpose.

Subtraction Method :

In this method, the difference between sale and purchase is taxed adopting prescribed rate of tax. Tax is charged only on the value added at each stage of sales of goods, the question of grant of claim for set of tax credit does not arise. This method normally applied where total sales and purchase are tax inclusive value. This method is applied, when there is only one rate, it is difficult to apply this method. It is argued that by this method, income is taxed. This is not true. The Value Addition at each stage may not only be due to profit but also may be due to freight, transportation and other services. The incidence to tax of tax is on sales of goods. This method therefore cannot said to be imposing tax on income or profit. For the purpose of calculating VAT liability of a dealer, the difference between goods purchase and gross sale (when both are tax inclusive) is arrived and the following formula is applied.

$$\text{Value Added Tax} = \frac{\text{Taxable turnover X Rate of Tax}}{100 + \text{Rate of Tax}}$$

$$= \frac{T \times R}{100 + R}$$

T = Taxable Turnover R = Rate of Tax

As seen above, the subtraction method is based on turnover and is applicable only when there is common rate of tax. When this method is applied, where there are more than one rate of tax, it shall cause complexities in maintenance of accounts. For example, each and every sale and purchase of particular goods have to be culled out and sale value has to be arrived at. This leads to one to one comparison which is not desirable for both traders and the administrators. This is not adopted in most of the VAT countries. Only Japan adopted this subtraction method, when it introduced VAT at 3% in 1989.

Tax Credit Method (ITC) or Invoice Method:-

In this method, to determine VAT liability, tax paid on purchase is deducted from tax payable on sales. The difference is tax payable to Government or excess refundable to the dealer for the period. Under this method, tax is imposed at every stage of sales on entire sale value and tax paid at entire stage, is allowed as set off. The most important feature of this method is, that at each stage, tax is to be charged separately. Tax paid on input value of goods and tax payable on sale value of goods is more important. The concept of turnover is not important. The purchase invoice showing tax invoice or voucher, it is called **Tax invoice Method or Voucher Method.** Further, in this method, tax credit is created, in favour of dealer, as soon as he pays tax on purchases and therefore it is called popularly as **Tax Credit Method.** This is very popular in western countries. In India also, at present this method is followed in Central Excise Law.

Though for illustration, tax liability is determined on one to one basis, actually it is not so. The tax paid on entire purchase of particular period is totaled and deducted from total tax collected or payable on entire sales of that period. From the above illustration, it is clear that under this method, **tax credit cannot be claimed unless and until the purchase invoice is produced.** In chain of transaction, at any stage, if the transaction is kept out of books, there is no revenue loss to Government, as full tax is collected in the next stage. The possibility of tax evasion is minimum, though not entirely ruled out. There is problem to

Illustration II:

Stages	Particulars	Turnover for tax Under VAT	Tax at 10%
1.	‘A’ sells the goods to ‘B’ distributor at say Rs.2200/- inclusive tax	2200	200
2.	‘B’ sells the goods to a whole saler (C) at say Rs.2500/- Taxable turnover 2500-2200 = 300	300	27.27
3.	‘C’ sells the goods to Retailer (D) at Rs.2900. His taxable turnover 2900-2500 = 400	400	36.36
4.	The Retailer sales to consumer at Rs.3500. His taxable turnover 3500-2900 = 600	600	54.54
5.	Total tax collected at different stages		318.17

In case of sale exclusive of tax (Rate of tax 5%)

	Turnover	Tax
A sells goods to B at Rs.1000/-	1000/-	50/-
B sells goods to C at Rs.1500/- (1500-1000)	500/-	25/-
C sells goods to D at Rs.1700/-	200/-	10/-

Illustration:-

Stage	Particulars	VAT Liability	Less VAT Credit	Tax to Government
1.	First seller in the State sells the good to distributor for Rs.100/- . Rate of tax is 10%. Therefore, his tax liability will be Rs.100/-. He will not get any VAT credit Being the first seller. (Goods purchased from Outside the State)	100	—	100
2.	Distributor sells the goods to a wholesale dealer for say Rs.1200/- at 10% and will get set-off of tax paid at earlier stage at Rs.100/-. His tax liability will be Rs.20/-.	120	100	20
3.	Wholesale dealer sells the goods to a retailer say at Rs.1500/-. Here again he will have to pay the tax on Rs.1500/-. He will get credit of tax paid at earlier stage at Rs.120/-. His tax liability will be Rs.30/-	150	120	30
4.	Retailer sells the goods to consumers say at Rs.2000/-. He will get credit for tax paid at Rs.150/-. His tax liability will be Rs.50/-	200	150	50
	Total	570	370	200

Illustration I :- The trading activity of a dealer in the month of December 2003 is as follows:

Date	Purchase	Rate of Tax	Tax paid	Sales	Rate of tax	Tax collected or Tax payable
2.12.2003	85,241/- 28,166/-	10% 8%	8,524.10 2,253.28	20,156.00 5,413.00	10% 8%	2,015.60 433.04
3.12.2003				41,064.00 8,326.00	10% 8%	4,106.41 666.08
5.12.2003	31,004/-	10%	3,100.40	50,122.00 12,133.00	10% 8%	5,012.20 970.64
6.12.2003	1,12,133/- 1,13,122/-	10% 8%	11,213.30 8.969.76	14,121.00 1,111.00	10% 8%	1,412.10 88.88
7.12.2003				51,322.00 60,040.00	10% 8%	5,132.20 4,803.20
8.12.2003				40,122.00 50,121.00	10% 8%	4,012.20 4,009.68
10.12.2003				25,166.00 22,140.00	10% 8%	2,516.60 1,771.20
				34,060.80		36,950.03

Tax payable Rs.36,950.00 – Rs. 34,061 (rounded) = (-) Rs.2,889.00

department in tackling take invoices. But the same may be controlled by systematic cross checking of tax credit claim it is better to allow tax credit claim only after cross verification.

This method is desirable to Trade and Industry because in the above example, the total tax collection at all stage is Rs.570/-, whereas tax received by Government is only Rs.200/-

As stated earlier, it is not one to one basis. Tax paid on purchases and tax collected or payable on sale is compared and VAT liability is arrived.

Excess tax credit carried down	-	Rs.33,832.00
Tax paid on purchases during this month	-	Rs. 3,148.00
Total tax credit	-	Rs.36,980.00
Tax collected in the month	-	Rs.38,359.00
VAT due payable		
Rs.38,359.00 – Rs.36,980.00	=	(-) Rs.1,379.00

From the above illustration, following facts are emerged:-

1) Excess tax credit in the month of December 2003 is carried over to month January 2004.

2) Purchases during this month is less than sales. This leads to infer that sales were effected from opening stock. Before allowing tax credit the opening stock is to be thoroughly verified.

3) As stated earlier purchases and sales are not compared on basis of one to one

4) The concept of turnover disappeared in qualification of tax liability.

Merits of Tax Credit Method:-

Most of the countries which implemented VAT adopted this indirect method, though other direct methods for computation of tax are available, for following reasons:-

1) It attaches importance to tax liability of transaction making it legally and technically far superior to other methods of computation.

Illustration II :- Purchases and sales of a dealer in the month of December 2003 is as follows.
Rate of tax are 8% and 10%

Date	Purchase	Rate of Tax	Tax paid	Sales	Rate of tax	Tax collected or Tax payable
1.12.2003	1,25,000/-	10%	12,500/-	33,220/-	8%	2,657.60
	55,400/-	8%	4,432/-	21,458/-	10%	2,145.80
2.12.2003				5,000/-	10%	500.00
6.12.2003				4,500/-	8%	360.00
				15,200/-	10%	1,520.00
10.12.2003	1,55,640/-	8%	12,451.20	40,005/-	8%	3,200.40
	21,300/-	10%	2,130/-	1,450/-	10%	145.00
12.12.2003				80,148/-	8%	6,411.84
14.12.2003	80,151/-	8%	6,412.08	72,504/-	8%	5,800.32
20.12.2003	23,541/-	10%	2,354.10	2,21,133/-	10%	22,113.30
26.12.2003	3,03,251/-	10%	33,325.10			
	2,01,122/-	8%	16,089.96	1,21,203/-	8%	9,696.24
	Tax liability		89,494.24			55,661.50
						(+) 33,8327
The excess tax credit in the month of December shall be carried over to next month						

Illustration III :-

Date	**Purchase**	**Rate of Tax**	**Tax paid**	**Sales**	**Rate of tax**	**Tax collected or payable**
2.1.2004				23,404/- 30,320/-	8% 10%	1,872.32 3,032.00
3.1.2004				12,310/- 18,454/-	10% 8%	1,231.00 1,476.42
5.1.2004				46,310/- 24,326/-	10% 8%	4,631.00 1,946.08
8.1.2004				1,11,102/- 50,640/-	10% 8%	11,110.20 4,051.20
10.1.2004	14,326/-	10%	1,432.60	22,164/- 13,010/-	10% 8%	2,216.40 1,040.80
20.1.2004	21,444/-	8%	1,715.52	42,144/- 12,441/-	10% 8%	4,214.40 995.28
31.1.2004				4,440/- 1,230/-	10% 8%	444.00 98.40
Total			3,148.12			38,359.40

How Tax Credit Method and Subtraction Method work – A comparison:

1. Trading Account of a Trader:-

Opening Inventory	5,00,000/-	Sales	80,00,000/-
Purchases	70,00,000/-	Closing inventory	6,00,000/-
Inward Expenses	70,000/-		
Profit	10,30,000/-		
	86,00,000/-		**86,00,000**

In Tax Credit Method	In Subtraction Method
Credit 6% on Opening Inventory of 5,00,000 = 30,000/- 6% on purchases of 70,00,000/- = 4,20,000/- Total = 4,50,000/-	VAT = [Sale – (Opening Inventory + Purchases – Closing Inventory)] VAT will be payable on VAT Base = 80,00,000/- [5,00,000 + 70,00,000 – 6,00,000)] = 11,00,000/- VAT at 6% = 66,000/-
Debits: 6% on Total Sale of 80,00,000/- = 4,80,000/- Tax Payable (4,80,000 – 4,50,000 = 30,000/- In next year, closing inventory of Rs.6 Lacs will not be taken into account for tax credit Thus closing inventory is always free of tax element which is the main feature of VAT system	(i) Opening Inventory Valuation will be difficult in ascertaining the exact Purchase Price because valued on market rate (ii) Closing Inventory Valuation will be difficult in ascertaining the exact Purchases Price because valued on market rate and include the expenses which is not reabatablee. (iii) Item to Item tracking – Rate illustration makes difficult to ascertain the value addition.

2) It makes cross-check of tax paid at earlier stages more easy. Input tax is deducted only when tax is paid. Without invoice no input tax credit is allowed.

3) It permits more flexibility in design. It allows more than a single rate to be used.

4) It is helpful in releasing the burden of taxes when felt necessary e.g. on goods exported internationally.

In view of the above, the tax credit method has turned out to be more popular and has been adopted almost universally (with the notable exception is Japan) for implementing VAT.

Reversal of Tax Credit:

Reversal of Tax Credit means adjustment of input Tax Credit already claimed, on those goods sold, which are subsequently returned or unfructified sale or goods used for personal or business use.

Sales Return

Illustration:

During the month of September 2003, a trader purchased goods worth of Rs.5,00,000/- at the rate of 10% and the goods for Rs.7,00,000/- at the rate of 5%.

He effected the sales for Rs.5,00,000 taxable at 10% and Rs.6,85,000/- at the rate of 5%. Moreover, he accepted return of goods for Rs.25,000/- at the rate of 10%. Illustrate his tax liability in the month of September 2003.

The above situation may also be illustrated as follows:

Method I

Sl.No.	Purchase	Rate of Tax	Tax paid	Sales	Rate of Tax	Tax collected / Payable
1.	Rs.5,00,000/-	10%	Rs.50,000/-	Rs.5,00,000/-	10%	Rs.60,000/-
2.	Rs.7,00,000/-	5%	Rs.35,000/-	Rs.6,85,000	5%	Rs.34,250/-
	Return of goods Rs.25,000/- Considered as deemed purchases	10%	Rs.2500/-			
			Rs.87,500/-			Rs.94,250/-

Output – Input = 94,250 – 87,500 = Rs.6,750/-

Method II

Sl.No.	Purchase	Rate of Tax	Tax paid	Sales	Rate of Tax	Tax collected / Payable
1.	Rs.5,00,000/-	10%	Rs.50,000/-	Rs.6,00,000/-	10%	Rs.60,000/-
2.	Rs.7,00,000/-	5%	Rs.35,000/-	Rs.6,85,000/-	5%	Rs.34,250/-
				Rs. 85,000/-		Rs.94,250/-

Return of goods: Rs.25,000 at 10% Rs.94,250 – 85,000 + 9,250/-
(for which tax credit was already availed but now reversed (-) 2,500/-
Net payable Rs. 6,750/-

(This method is applicable with modification for unfructified sale, goods subsequently taken for personal or business use).

Purchase Return:

What is sales return to a seller is purchase return to the buyer. In regular course of business, the purchaser as soon as he purchased, he could have claimed input tax credit, when part or whole of such purchases are returned, the input tax credit already availed is to be reversed.

Illustration: 'A' purchased goods for Rs.5 lacs taxable at 5% in the month of February 2002. He sold for Rs.6 lacs. He returned goods for Rs.1 lac at the rate of 5% to his supplier, work out his VAT liability.

Purchase	Rate of Tax	Tax paid	Sales	Tax Payable
Rs.5,00,000/-	5%	Rs.25,000/-	Rs.6,00,000/-	Rs.30,000/-
Purchase return Rs.1,00,000/-	5%	(-) Rs. 5,000/-		
		Rs.20,000/-		

Output – Input = Rs.30,000/- (-) Rs.20,000/-
VATability for the month of Feb.2003 = Rs.10,000/-

II. The difference between Tax Credit Method and Subtraction Method:-

Sl.No.	TAX CREDIT METHOD	SUBSTRACTION METHOD
1.	The VAT liability can be competed by deducting the tax deposited on purchases from the tax collected or payable on sales. This method requires that the amount of VAT charged be explicitly stated on the invoice associated with any taxable transactions. **Value Added = Tax on outputs – tax on inputs**	The VAT liability of a dealer is computed by applying the appliance VAT rate to the difference between his total sales and total purchases. Value Added = output - Input
2.	An input tax rebate is allowed only to the extent the tax was actually paid on the purchase and the payment is evidenced by a valid invoice from the supplier. This is a very important self-policing feature of VAT and critical for including proper tax compliance. Thus this system makes cross-checking of tax paid at earlier stages more amendable.	This feature is missing in this method.
3.	A rebate is allowed at the time **the input goods are purchased,** regardless of when they are eventually used in manufacturing or resold. This system frees the inventory from the tax burden and obviates the need for input contents determination at the time of sale of goods. This system can operate on the basis of books of accounts. **Without any need for determination of the time of use of the inputs.**	A deduction for the purchase cost of the goods only at the time those goods are resold. The rebate claim of manufacturers in respect of inputs is also delayed until the goods are manufactured and sold. As a result, the tax remains embedded in the inventory of raw materials and goods for resale and increases the inventory costs of the dealers. Also this system requires the complex rules for determining the input contents of the goods being sold and rebatable amount of tax on those outputs.
4.	Exports can be fully relieved of domestic taxes through zero rating of exports.	Actual quantification of domestic tax is difficult.
5.	The total burden of tax on a particular commodity is clearly seen from the transaction. Because of the transparency, it is possible to quantify at any stage, precisely the tax borne at the earlier stages.	VAT loses its transparency
6.	**Has the merit on administrative ground (**inherent advantage of calculating tax liability)	Has the merit of simplicity
7.	Inventory remains free of tax because rebate is granted as soon as the goods are purchased. No chances of manipulation of inventory.	More chances for inflating the inventory and manipulating the rebatable value.
8.	Emphasis on self-enforcement.	Requires intensive enforcement

Chapter - 4

Exemptions and Zero Rating

Under VAT, a distinction is made between exemption and zero rating. Exemption usually means exemption from tax on the value added of a commodity at a particular stage of production or distribution. If full exemption is desired, then there should be zero rating of the concerned commodity. That is, a rate of zero should be imposed on the commodity against which rebate should be given for input taxes. This is a particularly useful tool for exports. In order to maintain the international competitiveness of a commodity, exports out of a tax jurisdiction can be relieved of all domestic taxes through zero rating. Exemptions are not desirable under VAT as they break the input tax credit chain. If this commodity re-enters the production process as an input for a taxable commodity, the problem of cascading reappears. Also exemption from tax at one point does not mean total exemption because taxes on inputs at the earlier stages will remain embedded leading to loss of transparency. Thus, an exemption does not imply a zero effective tax rate on the commodity. Exemptions should be kept to the minimum.

Exemption:

Provision for exemption from tax is unavoidable in any tax system. The exemption means, the trader is not required to pay tax on sales or purchases. It is generally provided for following reasons.

1) To reduce administration and compliance cost
   a) Small businesses
   b) Agriculture

2) Difficult to apply rate of tax
   Financial service

3) Social Policy
   a) Health
   b) Education
   c) Cultural activities
   d) Non-profit centre

In Sales Tax statue, the exemption is granted or provided for institutions or organisation, Individuals and goods. Generally goods are exempted by enlisting them in the schedule annexed with statue. The exemption for individuals or institutions is granted by notification by Government. So, the exemption is classified as:

Exemption

For Institutions | For Individuals | Goods

In VAT, Exemption means exemption from tax on value addition in commodity at a particular stage of production or distribution Tait puts it, "A linguistic quirk of the VAT is that 'exemption' actually means that the 'exempt' trader has to pay VAT on his inputs without being able to claim any credit for this tax paid on his inputs without being able to claim any credit for this tax paid on his inputs". Exemption under VAT, is not desirable as it breaks VAT chain. Any exemption either at first stage or last stage or intermediate stage will not only break VAT chain but also results into cascading.

A) 1) *Exemption to a manufacturer*:

When purchase by a manufacturer is exempt and his sale is subjected to VAT, the manufacturer cannot get input tax credit. But he has to pay full tax on his sale.

2) If the same manufacturer's sale is exempt, he shall not get input tax credit on his purchases. Further his purchaser has to pay full tax when he sells the goods. That is, purchaser from such manufacturer is first seller without benefit of input tax credit.

B. If exemption is granted in the middle

'A' sells goods to 'B' whose sale is exempt by notification 'A' is entitled for input tax credit, whereas 'B' will not avail input tax credit as his sale is exempt. Then the dealer who purchases from 'B' will also not be eligible for input tax credit as he did not tax on purchase. So he has to pay full tax at the appropriate rate.

C. If last sale – Retailer is exempt.

'B' is a retailer, purchases goods from 'A' after paying tax at the rate prescribed. As his sale is exempt, he neither collects tax on sale nor claim input tax credit, as there is no tax liability.

Thus the exemption at any stage of sale. (1) Breaks VAT chain (2) Tax element is carried along with price of goods.

The purpose of implementation of VAT system is to avoid building up tax element into price of goods. When exemption is granted, this purpose is defeated. The part of the value added is taxed more than once and that a tax on tax cascade is introduced into VAT. It is therefore not desirable to grant exemption under VAT. However, if the provision for exemption is inevitable, such exemption may be very minimum.

Zero Rating :

Zero rating means that a trader is not only exempted from payment of VAT on his sales, but he is also allowed to get refund for any taxes paid on his inputs. To put it in simple form, the trader does not charge tax on his sale but gets the refund of the tax paid on his purchases. In India the Value Added Tax System is based on destination principle and therefore it does not aim to tax goods originated from one State to other or from India to outside the country. But when such goods were purchased, the tax would have been paid on such goods is also exported. To avoid this the tax paid on purchase of those goods is to be credit is created in the accounts of the purchasing dealer in the tax department. The zero rated sale does not bear any tax. The tax paid on purchases which is available as tax credit of the dealer in the department is nullified by refunding that account. It is therefore, called zero rated. The zero rate sales are generally:

1) Export
2) Inter-state sale
3) Sale to international organization that is generally notified by the Government
4) Some sales which are notified as zero rate sale by Government – in fact in Singapore the sale of health monitoring equipment, spectacle lenses is zero rate. In European countries the sale of food is zero rate. It means sale of such goods not only free from tax but tax paid on purchases of such goods is refunded. This is to curtail hike of price of such goods and help the poor.

Comparison of Exemption and Zero Rating:

Exemption	Zero Rating
1. Only Value Added is exempt at a particular stage. So do not provide complete relief from tax.	Tax on purchase is totally relieved.
2. Not eligible for input tax credit.	Eligibility for refund of input tax credit.
3. Trader is kept out of VAT. He is treated as final purchaser in the VAT chain.	Trader is in VAT chain.
4. All purchases including capital goods are taxed.	Though taxed, the same is refunded.
5. Exempted traders need not register with tax authorities nor keep records for VAT.	Traders should necessarily get registered and keep all prescribed accounts.
6. Simplify the administration but introduce in equities.	Not in equities. But system of refund involve high administrative cost only to compensate the traders and not to raise the revenue. The churning of money is administratively wasteful and undesirable.

Comparison of Taxable, Zero Rated and Exempted Sales:

Type of sale	Tax on sale	Input Tax Credit (I.T.C)
Taxable	Yes	Yes
Exempted	No	No
Zero rated	No	Yes

Chapter - 5

Choosing a base for VAT

There are three possible variants of VAT, depending upon what macro-aggregate the government wants to tax: gross income, net income or consumption. In terms of the macro aggregates,

Gross Product

= consumption + gross capital formation

= gross value of output - all current inputs

A VAT on gross income would therefore treat both consumption and capital formation as final uses of the goods; hence capital goods purchased by the dealer would not be **treated as** inputs. Input tax credit will not be available on taxes paid on capital goods.

Net Income

= consumption + gross capital formation - depreciation

= gross income - depreciation

= gross value of output - all current inputs - depreciation

VAT on net income would therefore give credit for tax paid on current inputs and tax paid on capital goods to the extent attributable to depreciation of capital goods, in any given year. Under the ITC method, this implies that the credit for tax on capital goods will be spread over the life of the capital goods.

The consumption type VAT goes a step further in that only final consumption is treated as the final use of a goods; full credit, therefore is given for taxes paid on capital goods as well, in the year of purchase.

Consumption

= gross value of output current inputs - gross capital formation

Table illustrates the calculation of VAT with three alternative bases.

Table : Comparison of VAT on alternative bases

	Value of output	Computation of VAT at 10%		
		consumption type	income type	gross product type
Intermediate inputs				
Output	Rs.200	Rs.20.0	Rs.20.0	Rs.20
Capital goods				
Output	Rs.150	Rs.15.0	Rs.15.0	Rs.15
Inputs	Rs.100	- Rs.10.0	- Rs.10.0	- Rs.10
Tax paid		Rs. 5.0	Rs. 5.0	Rs. 5
Consumption goods				
Output	Rs.300	Rs.30.0	Rs.30.0	Rs.30
Inputs	Rs.100	- Rs.10.0	- Rs.10.0	- Rs.10
Capital	Rs.150	- Rs.15.0	- Rs. 1.5	
Tax paid	Rs 5	Rs 18.5	Rs.20.0	
Tax collection	Rs 30	Rs 43.5	Rs.45.0	
Total consumption	Rs.300			
Total income	Rs.435			
Total production	Rs.450			

Note: This example takes the case of a simple economy with three producers producing consumption goods, intermediate inputs and capital goods, respectively. Both consumption goods and capital goods require intermediate goods for production. Further, capital goods are used for producing consumption goods. It is assumed that intermedite goods do not use any inputs.

A tax on production or on income potentially distorts and discourages investment decisions, affecting the growth of the economy. A tax on income for instance, could alter consumer decisions in favour of present consumption, because it implies double taxation of savings (Savings are taxed at the time of saving and again the income from savings is taxed. Hence, some economists favour a personal progressive tax on consumption. However, since it is extremely difficult to administer a progressive personal consumption tax, an indirect consumption tax is preferred along with an income tax. The consumption tax could be made progressive with respect to consumption but tends to become regressive with respect to income. Therefore, if there exists a direct income tax, better calibrated to the ability to pay, a VAT of the consumption type at a single rate is found to be preferable, as the general practice the world over illustrates.

If total consumption is to be taxed in a national VAT with imports and exports, (The base for a state VAT would be similar except for direct import of consumer : as per the Indian constitution , the state cannot levy a tax on such imports) the base of the tax will effectively be domestic : output + imports - exports - current inputs - capital goods (i.e., gross investment).

AN ASSESSMENT OF VAT IN COMPARISON TO A CASCADING SALES TAX

VAT by the ITC method helps overcome problems we encounter in cascading types of sales tax. In addition to being a transparent tax, VAT by the ITC method has several advantages which are discussed below.

- Deriving from the fact that VAT by the ITC method permits easy and effective targeting of tax rates, exports can be zero rated, i.e., goods being exported out of the jurisdiction can be given complete refund of taxes paid at the earlier stages. In the ITC method, this implies that only the tax paid at the penultimate stage needs to be refunded to the exporting dealer.

- 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.

- Since all stages of production and distribution are subject to tax, this form of taxing avoids the problem of under-valuing, without introducing cascading.

- Since the dealer gets a set-off for taxes paid at the earlier stages, these are not treated as part of costs and this is expected to reduce that component of cost as well as the associated financing requirements. Further, the problem of enhanced cascading via the mark-up rule too, is curtailed.

In addition, the input tax credit method, by generating a trail of invoices, is argued to be a 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.

From the point of view of the state, another interesting feature of VAT is its stability as a source of revenue. Owing to the fact that consumption is more stable than income, VAT provides a very stable source of revenue.

VAT AND RETAIL SALES TAX: A COMPARISON

It has been shown that VAT is a form of consumption tax, which does not in any way cause changes in productive activities either in terms of allocation of resources or in terms of costs. Therefore, VAT is a method of reaching consumption without affecting productive activities. It is well acknowledged that a true retail sales tax has the same merit. Since it is a tax levied at the end of the chain of all production transactions and is collected from the final users, it does not cause any alterations in productive activities. That is why it has been argued that VAT and the retail sales tax are economically equivalent.

While economically VAT and the retail sales tax are equivalent, the former is preferable on administrative grounds. In both cases, all dealers with turnover above the stipulated threshold will have to register and file returns. (This is true of the first point tax also.) However, in the case of the retail sales tax, the entire tax is to be paid by the last registered dealer (the retail seller). There is correspondingly greater tendency for evasion. Under VAT, generally, only a small part of the tax is to be collected from the dealers at the lower end of the chain. The administration needs to concentrate attention mainly on the larger dealers (Of course in terms of choosing a sample for checking,dealers could also be chosen on the basis of other criteria such as, large input tax credit.)This is administratively easier. Further, since the tax is collected in instalments under VAT, there is greater possibility of cross checking.

The state governments in the United States of America levy what may be called a retail sales tax. With a moderate rate - generally a single rate of 7 to 11 per cent - they have been successfully operating their sales taxes. They have been able to do so because the most important retailers there are large sized and are in the organised sector. Moreover, most sales to customers are put through cash registers and the taxes are routinely collected by the cash counter salespersons. In such circumstances, the operation of a retail sales tax is feasible.

However, there is dissatisfaction in USA about the retail sales tax now in regard to both administration and cascading (because producers also buy from departmental stores). In India, on the other hand, account keeping at the retail level is poor and it would not be advisable to try to collect the entire tax at that level (We do note that three states in the country, Delhi, Punjab, and Haryana, still rely mainly on last point tax. However Delhi and Haryana finding it difficult to implement, have shifted a number of goods to the first point. The implementation of last point taxes has required the use of a considerable volume or statutory forms too, making it a tedious tax to administer or comply with.)

SOME ARGUMENTS AGAINST VAT

The introduction of VAT has sometimes been opposed on the following grounds. First, VAT is more complicated than a simple cascading first point tax. The taxpayer has to keep accounts not only of sales but also of purchases and taxes paid on those purchases. Since the tax liability will be based not merely on the value of the total turnover but also on the tax paid on the inputs, there is more administrative work involved. Thus, it is argued that for both taxpayers and administrators VAT is a more difficult tax to operate. Strictly speaking, it is not true that under the first point tax purchase vouchers need not be maintained or checked. Since the tax administrators have to verify in the case of a reseller, that the dealer concerned has paid tax on his purchases, purchase vouchers have to be preserved for being checked, if considered necessary. However, it is true that more account keeping is needed under VAT. As against this, since there will be only a few rates at the most, very few exemptions and all dealers above the threshold will pay tax, in a way VAT is also a very simple tax to administer and to comply with. It may also be noted that the number of dealers who have to register and submit returns will be the same under the first point tax, the last point tax, and VAT. The difference, of course, is that under VAT all registered dealers except those zero rated will be paying some tax.

Second, it has been argued that the introduction of VAT would cause some inflation. This argument has been used particularly in countries where there was no general sales tax but only a few excises. In countries such as India, where there exist sales taxes already covering a wide range of commodities, replacement of those taxes by a revenue neutral value added tax should lead to no inflationary consequences (This is supported by emperocal studies, puroht (1993), pp 21-23). In fact, with a reduction in the extent of cascading there should indeed be a fall in prices. Of course, if the government is deliberately using VAT as a means of raising more revenue in a rational manner, there would be some increase in prices, but then the rise in prices cannot be attributed to VAT.

Third, VAT has been criticised as a regressive tax. As pointed out earlier, a full-fledged VAT levied at a single rate with no exemptions would be equivalent to a proportional tax on consumption (capital goods being exempt). However, like all consumption taxes, VAT will be regressive with respect to income insofar as consumption falls as a proportion of income as income rises. This regressivity could be mitigated to some extent by having excises at higher rates on a few goods largely consumed by the richer sections of society. Also, what is important is the characteristic or impact of the total tax system. As has been argued earlier, if at least a moderately progressive income tax with a reasonably high exemption level is in place, the system as a whole will be a progressive t e. In any case, VAT is no more regressive than any other general tax on commodities and services.

Chapter - 6

VAT Glossary

BRANCH TRANSFER IN VAT / CONSIGNMENT DISPATCH IN VAT

Branch transfer / consignment dispatch will be an exempt transaction. In the model Draft Act drafted for the Ministry of Finance by Shri Tare, Consultant and Input Tax Credit is proved on Input Tax paid in excess of 4%. One has to refer to the Draft VAT Act of the respective States for more precise Information.

CAPITAL GOODS / CAPITAL ASSETS IN VAT

Ideally Input tax credit should be available on capital goods, purchased and used in the manufacture of goods. Since, in Capital intensive projects, the input tax credit is likely to be large and the State may not be able to realize revenue if input tax credit likely to be large and the State may not be able to realize revenue if input tax credit on capital goods is allowed to be set off against output tax in the period of purchase.

It is, therefore likely that the input tax credit on capital goods may be deferred over a period of time.

"Capital Goods" will therefore have to be defined properly to avoid confusion. Definition in some of the States is as follows:

State	Sec	Capital Goods
Assam	2(8)	(8) "Capital Goods" means plant, machinery, equipment, moulds and dies purchased for the purpose of manufacturing or processing of goods in the State or for use in packing of such goods where the purchase thereof has been capitalized, but excluding civil structures as may be prescribed;
Delhi	2(e)	(e) "Capital Goods" means plant, machinery and equipment used in the process of manufacturing.
Haryana	2(g)	(g) "Capital Goods" means plant, machinery and equipment purchased for the purpose of manufacturing of goods in the State for sale, where the purchase thereof has been capitalized and includes purchase of right to use such goods, whether such purchase is capitalized or not:
Karnataka	2(7)	(7) "Capital Goods" means plant, including cold storage and similar plant, machinery, goods vehicles and equipment or any other goods whose total costs is not less than an amount to be notified by the Government or less than an amount to be notified by the Government or the Commissioner, and used in the course of business other than for sale.
Orissa	2(11)	(11) "Capital Goods" means plant, machinery and equipment costing not less than Rs.20,000/- and used directly in the manufacture, processing, production or packing of good in the State of Orissa for sale, where the purchase thereof has been capitalized and includes purchase of right to use such goods, whether such purchase is capitalized or not.
Rajasthan	2(10)	(10) "Capital Goods" shall mean such goods as may be notified by the State Government from time to time; 5
Tamil Nadu	2(12)	(12) "Capital Goods" means goods specified in the Sixth Schedule
Uttranchal	2(9)	(9) "Capital Goods" means plant, machinery and equipments Used in manufacturing or processing of goods or packing of manufacturing goods for sale by such dealer, (whether directly or indirectly) excluding civil structures as may be prescribed;
VAT Model	2(vii)	(vii) "Capital Goods" means plant, machinery and Equipment used in the process of manufacturing excluding civil structures as may be prescribed;

Input tax credit on capital goods not used in the manufacture of goods shall not be available.

COMPOSITION OF TAX / PRESUMPTIVE TAX / TURNOVER TAX

Dealers below the VAT threshold limit and who have not opted for VAT registration will be required to pay a presumptive compounded tax on the entire sales turnover at 1% or 2%.

This facility is likely to be available only to retail dealers. The Dealer paying compounded tax will not be eligible to issue VAT tax invoice.

DECLARED GOODS IN VAT

Declared goods are those specifies in the Central sales Tax Act as goods of importance in the course of interstate trade or commerce. The State Sales Tax / VAT Acts are Prohibited from levying tax at more than 4%.

In the Finance Act 2002, the restriction on taxation of Declared Goods at more than one point of sale has been removed. Therefore, under VAT, Declared Goods will also be subject to tax at a rate not exceeding 4%.

DEEMED SALES IN VAT

Deemed sales are those which are not really “sales” but have been deemed as sales. For Instance, leasing and hire purchase transaction, work contract, transfer of right to use goods are instances of deemed sales that are taxed under the Sales Tax Act.

The inclusion or otherwise of deemed sales under VAT differs from State to State. For instance, West Bengal Draft VAT ACT specifically excludes deemed sales. In States where deemed sales are brought under VAT, proper rules need to be framed for grant of input tax credit.

DEFERRAL OF TAX IN VAT / INDUSTRIAL INCENTIVE IN VAT

VAT presupposes uniformity and neutrality as between goods or class of dealers. Therefore, naturally there is no place for tax holidays or deferral of tax under VAT.

One issue baffling tax administrators is as to how to integrate into VAT the existing tax concessions, tax holidays and tax deferrals that have already been granted and are likely to continue for several years beyond 2002.

Maharashtra Government have proposed to convert tax holidays into tax deferral. The issue is contentious and we may have to wait for a clearer picture.

EXEMPT GOODS TAX FREE GOODS / TRANSACTION / DEALER

Exempt goods are those on which no VAT is levied in the entire supply chain. An exempt transaction is one that is exempt from vat either at a point of sale or when a sale is affected by a specified dealer or specified dealers. In case of VAT exempt transactions the VAT chain breaks at the point of exemption. The Dealer effecting the exempt sales will not be eligible for input tax rebate.

The difference between an exempt sale and a zero rated should be properly understood.

An exempt dealer pays vat on his purchase, but is not entitled to claim input tax credit as he cannot charge vat on his exempt sales.

A dealer effecting zero rated sales claims refund of the VAT on his inputs but pays no tax on his output. Eg. Exports.

EXPORT SALES IN VAT

An export sale will be a zero rated sales. The exporter will have to claim refund of the input tax on the goods exported.

At present a sale penultimate to exports is exempt subject to conditions. To enable the exporter to claim refund of input tax credit section 5(3) of the CST Act may have to be amended.

THRESHOLD LIMIT –GENERAL REGISTRATION

General Registration threshold refers to the turn over limit above which a dealer should compulsorily register as a dealer. The general registration threshold limit is likely to be Rs.3 lakhs to Rs.5 lakhs.

Dealers below the threshold limit may opt for voluntary General or VAT registration.

INPUT TAX

Input tax is the tax paid under the State VAT Act on purchase from a VAT registered dealer. Input tax does not include the tax paid on interstate purchase.

INTERSTATE SALES IN VAT

There is not likely to be any change in the present system or levy of tax on inter State sale for the year 2003-2004. From press reports, it is seen that the rate of tax is likely to be reduced to 2% with effect from 2004-2005 and that the tax rate will be 0% from 2005-2006.

Even after reducing the rate of tax to 0%, CST Act is likely to continue to monitor and regulate Inter State in the VAT regime.

In the Finance Bill 2002, Form c has been made compulsory for all inter State Sale at concessional rate. Form c has been made compulsory in respect of exemption/reduction in rate of tax granted by State Governments under Section 8(5) of the CST Act. The implication is that the reduction in rate of tax under Section 8(5) of the CST ACT will not apply to any person other than a registered Dealer.

INPUT TAX CREDIT / REBATE / SET OFF

Input tax credit means that the tax paid on purchase effected within the State shall be allowed to be set off against the output tax payable. The input tax credit will be eligible only on purchase effected from VAT registered dealers.

Input tax credit shall not be available on purchases that are used for personal consumption or provided free of charge as gifts.

Input tax credit will not be available on Inter State purchase. However, Pondhicherry has granted input tax credit of CST paid.

Input tax credit shall be available only on goods purchased for the use in manufacture of other goods or for resale.

Where a dealer effects partly taxable sale and partly exempt sales, input tax credit will be available prorate with reference to the taxable sale.

Input tax credit will not be available for special additional tax.

See also **Capital Goods**.

OUTPUT TAX

Output tax is the tax payable by a registered dealer on the sale of goods effected.

PERIOD

Period refers to the period for which the dealer is required to file returns. The period under the VAT Act is likely to be monthly for VAT registered dealers and quarterly for retail dealers with general registration.

PURCHASE TAX

Purchase tax is the tax levied on purchase of capital goods or other goods from unregistered dealers. Input tax credit will, of course, be available for the purchase tax paid.

RATES OF TAX IN VAT

One of the much acclaimed features of VAT is that the rates of tax are likely to be few.

The likely rates of tax are 0%, 1%, 4%, revenue neutral rate and two or more rates of tax for goods like petroleum products, liquor etc.

RNR – REVENUE NEUTRAL RATE

The revenue neutral rate is the rate of tax at which the revenue accruing to the State Government under the present system of levy of tax and VAT is neutral.

There is unfortunately not enough statistics or a reliable mathematical models to arrive at the RNR. So be prepared for mid year revision of RNR if the revenue to the State is not buoyant. The Empowered Committee of State Finance Ministers have recommended that the RNR should be initially in the range of 10% to 12.5% to be progressively made uniform in all States.

REGISTRATION – GENERAL

A retail dealer with turnover below the VAT threshold limit but above the minimum turnover limit for the registration will be granted a general registration. A dealer with general registration will not be eligible to issue Vattable invoices.

A manufacturer or an importer of goods will not be eligible for general registration. A dealer with general registration is required to pay presumptive tax.

REGISTRATION – VAT

A dealer with turnover above the VAT threshold limit is required to register under VAT. A VAT registered dealer only will be eligible for input tax credit.

RETAIL DEALER

A retail dealer is one who predominantly sells in retail. A retail dealer below the VAT threshold limit may opt for payment of tax at compounded rates or may apply for VAT registration. A retail dealer has been defined in the Maharashtra Draft Act as follows:

"A dealer will be considered to be engaged in the business of selling at retail if 9/10th of his turnover of sales consists of sales made to persons who are not dealers".

REVERSE CREDIT OF INPUT TAX

There are restrictions on the eligibility of input tax credit depending upon the use of goods on which input tax credit has been availed and depending upon the manner of disposal of the goods on which input tax credit has been availed.

For instance, where goods on which input tax credit has been taken is later on used in the manufacture of taxable and exempt goods, the input tax credit availed on goods used in the manufacture of exempt goods shall be reversed.

The input tax credit so reversed is "Reverse Credit".

SELF ASSESSMENT

Self assessment is finalization of assessment by the department based on the returns filed by the dealer without calling for and examining the books of accounts.

Since under VAT the tendency to evade tax is expected to be lower, the self assessment turnover limit is expected to be higher.

SPECIAL ADDITIONAL TAX

Special additional tax is the tax charged on goods in addition to the rate of tax eligible for

input tax credit i.e. the special additional tax will not be eligible for input tax rebate.

TAXABLE SUPPLIES / SALE

Taxable supply or sale is the sale liable to tax under the VAT Act i.e. a sale other than an exempt sale or a zero rated sale.

TAX IDENIFICATION NUMBER (TIN)

The registration number allotted to a VAT registered dealer is called tax identification number.

VAT TAX INVOICE / TAX INVOICE / RETAIL INVOICE

The Invoice prescribed for a sale to be eligible for input tax credit ids called VAT Tax invoice. Input tax credit will be allowed only if the tax invoice contains the particulars required to be specified.

The particulars required in a Retail Invoice will also be specified.

TREATMENT OF FREE SUPPLIES / BARTER IN VAT

Under VAT Input tax credit is allowed to be off against the output tax payable. Since no output tax is payable on free supplies or barter, the input tax relatable to the goods supplied free will be disallowed.

TRANSITION TO VAT

Since, under VAT, input tax is eligible for set off, the input tax element on the goods in stocks as on 31-03-2003 shall also be eligible to be set off against the output tax payable from 01-04-2003.

We will have to wait for the final VAT Acts to be sure that the tax element on the raw materials, trading goods and capital goods will be eligible for set off.

Dealers may have in stock goods that have been purchased over several years. It is likely that there may be a limit of say one month to three months on the period of purchase of goods that will be eligible for set off. So, dealers please have in stock only goods purchased within the last three months or such period as may be specified in the draft Act of your State.

Similar credit for goods in stock will also be eligible for dealers who have a general registration but become liable to be registered as a VAT dealer during the course of the year (after introduction of VAT).

UNIFORM SALES TAX FLOOR RATES (UST)

UST floor rates is the forerunner to the introduction of VAT. The UST rates were agreed upon by all the States as the floor rate for the goods below which the State shall not fix the rate of tax. The intention of the UST rates was to prevent the diversion of trade between States.

VALUE ADDED TAX (VAT)

VAT is a multi point levy with the facility to set off the tax paid on purchase against the tax payable on the sale of goods and services. VAT is in force in more than 100 Countries where VAT is applied to both sale of goods as well as services. Most of the countries that have introduced VAT developed economics and is centrally administered.

In India, we have CENVAT administered by the Center and now the State Sales Tax VAT to be administered by the States. This form of a sub regional VAT is prevalent, probably, only in Canada.

You may be surprised to know that in the USA there is no VAT.

Considering the Centre-State coordination and problems in revenue sharing, taxing of interstate sale, problems in taxing of services and certain goods subject to additional duty of Central Excise, please do not expect the transition to VAT to be Smooth.

VAT REFUNDS

Refunds in VAT will arise in the case of Zero Rated Sales.

Refunds may also arise in the case of a dealer whose input credit exceeds the output tax payable.

It is expected that the refunds on account of Zero Rated Sales may be processed faster, say, within a period of 3 to 6 months. The refund on account of mismatch of Input tax credit and output tax is likely to be deferred by 18 to 36 months from the period in which the refund arose.

THRESHOLD LIMIT-VAT REGISTRATION

VAT threshold refers to the turnover limit above which a dealer should compulsorily register for VAT. The VAT threshold limit is likely to be Rs.30 lakhs or thereabouts. Dealers below the threshold limit may opt for voluntary VAT registration. The threshold limit is not likely to apply to dealers other than retail dealers.

ZERO RATED SALES

A Zero rated sales is one on which no output tax is payable but input tax credit is eligible.

The difference between an exempt sale and a Zero Rated Sale should be properly understood.

An exempt dealer pays VAT on his purchases, but it is not entitled to claim input tax credit as he cannot charge VAT on his exempt sales.

A dealer effecting Zero Rated Sales claims refund of the VAT on his inputs but pays no tax on his output. Eg. Exports.

Chapter - 7

Tamil Nadu Value Added Tax Act, 2003 - Highlights

1 (2) Commencement :

It shall come into force on such date as Government may, by notification, appoint.

Definition :

2 (11) "Business" includes —

(i) any trade or commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any profit accrues from such trade, commerce, manufacture, adventure or concern; and

(ii) any transaction in connection with, or incidental or ancillary to, such trade, commerce, manufacture, adventure or concern;

2 (12) "capital goods" means goods specified in the Sixth Schedule;

2 (13) "casual trader" means a person who has, whether as principal, agent or in any other capacity, occasional transactions of a business nature involving the buying, selling, supply or distribution of goods in the State, whether for cash, or for deferred payment, or for commission, remuneration, or other valuable consideration, and who does not reside or has no fixed place of business within the State;

2 (16) "dealer" means any person who carries on the business of buying, selling, supplying or distributing goods, directly or otherwise, whether for cash, or for deferred payment, or for commission, remuneration or other valuable consideration, and includes—

(i) a local authority, company, Hindu undivided family, firm or other association of persons which carries on such business;

(ii) a casual trader;

(iii) a factor, a broker, a commission agent or arhati, a *del credere* agent or an auctioneer, or any other mercantile agent by whatever name called, and whether of the same description as herein before or not, who carries on the business of buying, selling, supplying or distributing goods on behalf of any principal, or through whom the goods are bought, sold, supplied or distributed;

(iv) every local branch of a firm or company situated outside the State;

(v) a person engaged in the business of transfer otherwise than in pursuance of a contract of property in any goods for cash, deferred payment or other valuable consideration;

(vi) a person engaged in the business of transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(vii) a person engaged in the business of delivery of goods on hire purchase or any system of payment by instalments;

(viii) a person engaged in the business of 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;

(ix) a person engaged in the business of supplying by way of, or as part of, any service or in any other manner whatsoever of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service is for cash, deferred payment or other valuable consideration;

Explanation -I A society including a co-operative society, club or firm or an association which, whether or not in the course of business, buys, sells, supplies or distributes goods from or to its members for cash, or for deferred payment or for commission, remuneration or other valuable consideration, shall be deemed to be a dealer for the purposes of this Act.

Explanation-II The Central Government or any State Government which, whether or not in the course of business, buy, sell, supply or distribute goods, directly or otherwise, for cash, or for deferred payment, or for commission, remuneration or other valuable consideration, shall be deemed to be a dealer for the purposes of this Act;

Explanation-III Each of the following persons or bodies who dispose of any goods including unclaimed or confiscated or unserviceable or scrap surplus, old or obsolete goods or discarded material or waste products whether by auction or otherwise directly or through an agent for cash or for deferred payment or for any other valuable consideration, notwithstanding anything contained in this Act, shall be deemed to be a dealer for the purposes of this Act to the extent of such disposals, namely:-

(i) Port Trust;

(ii) Municipal Corporations, Municipal Councils and other local authorities constituted under any law for the time being in force;

(iii) Railways administration as defined under the Railways Act, 1989;

(iv) Shipping, transport and construction companies;

(v) Air Transport Companies and Airlines;

(vi) Any person holding permit for the transport vehicles granted under the Motor Vehicles Act, 1988 which are used or adopted to be used for hire;

(vii) The Tamil Nadu State Road Transport Corporations;

(viii) Customs Department of the Government of India administering the Customs Act, 1962;

(ix) Insurance and financial corporations or companies and banks included in the Second Schedule to the Reserve Bank of India Act, 1934;

(x) Advertising agencies; and

(xi) Any other corporation, company, body or authority owned or set up by, or subject to administrative control of the Central Government or any State Government.

2 (17) "declared goods" means goods declared by section 14 of the Central Sales Tax Act, 1956, to be of special importance in inter-State trade or commerce;

2 (21) "exempted sale" means a sale of goods on which no tax is chargeable, and no input tax credit is admissible.

2 (22) "goods" means all kinds of movable property (other than newspapers, auctionable claims, stocks and shares and securities) and includes all materials, commodities, and articles including the goods (as goods or in some other form) involved in the execution of works contract or those goods to be used in the fitting out, improvement or repair of movable property; and all growing crops, grass or things attached to, or forming part of the land which are agreed to be severed before sale or under the contract of sale;

2 (23) "Government" means the State Government;

2 (24) "input" means any goods excluding capital goods but including consumables, packing material and labels for use in the manufacture, assembling, packing or labeling in connection with such manufacture inside the State, of any goods for sale;

2 (25) "input tax" means tax paid or payable under this Act by any registered dealer on purchase of any goods for manufacture or re-sale;

2 (27) "legal representative" shall have the same meaning as assigned to it in clause (11) of section 2 of Code of Civil Procedure, 1908;

2 (28) "manufacture" with all its grammatical variations and cognate expressions, includes every processing of goods which brings into existence a commercially different and distinct commodity;

2 (29) "output tax" means tax payable under this Act by any dealer in respect of sale of any goods;

2 (30) "place of business" means any place in the State where a dealer purchases or sells goods and includes

(i) a warehouse, godown or other place where a dealer stores his goods;

(ii) a place where the dealer processes, produces or manufactures goods; and

(iii) a place where the dealer keeps his accounts, registers and documents.

2 (31) "registered dealer" means a dealer registered under this Act;

2 (32) "registering authority" with reference to a dealer means the head of the assessment circle, in whose area of jurisdiction the principal place of business of the dealer is situated in the State or such other authority authorised by the Commissioner;

2 (33) "re-sale" means sale of any goods purchased within the State, in the same form in which they were purchased, or without doing anything to them, which amounts to, or results in a manufacture;

2 (34) "re-seller" means any dealer who makes a re-sale;

2 (35) "reverse tax" means that portion of input tax of the goods for which credit has been availed but such goods are used subsequently for any purpose other than re-sale or manufacture of taxable goods or use as containers or packing materials within the State;

2 (36) "rules" means rules made under this Act.

2 (37) "sale" with all its grammatical variations and cognate expressions means every transfer of the property in goods (other than by way of a mortgage, hypothecation, charge or pledge) by one person to another in the course of business for cash, deferred payment or other valuable consideration and includes

(i) a transfer, otherwise than in pursuance of a contract of property in any goods for cash, deferred payment or other valuable consideration;

(ii) a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(iii) a delivery of goods on hire-purchase or any system of payment by instalments;

(iv) a 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;

(v) a supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(vi) a supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating) where such supply or service is for cash, deferred payment or other valuable consideration, and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;

Explanation-I – The transfer of property involved in the supply or distribution of goods by a society (including a co-operative society), club, firm or any association to its members, for cash, or for deferred payment or other valuable consideration, whether or not in the course of business, shall be deemed to be a sale for the purposes of this Act.

Explanation-II – Every transfer of property in goods by the Central Government or any State Government for cash or for deferred payment or other valuable consideration, whether or not in the course of business, shall be deemed to be a sale for the purposes of this Act.

Explanation-III – Every transfer of property in goods including goods as unclaimed or confiscated or unserviceable or scrap surplus, old, obsolete or discarded materials or waste products, by the persons or bodies referred to in *Explanation-III* in clause (16) of section 2 of this Act, for cash or for deferred payment or for any other valuable consideration whether or not in the course of business, shall be deemed to be a sale for the purposes of this Act.

Explanation-IV - The transfer of property involved in the purchase, sale, supply or distribution of goods through a factor, broker, commission agent or arhati, *del credere* agent or an auctioneer or any other mercantile agent, by whatever name called, whether for cash or for deferred payment or other valuable consideration, shall be deemed to be a purchase or sale, as the case may be, by such factor, broker, commission agent, arhati, *del credere* agent, auctioneer or any other mercantile agent, by whatever name called, for the purposes of this Act.

Explanation-V- (a) The sale or purchase of goods shall be deemed for the purposes of this Act, to have taken place in the State, wherever the contract of sale or purchase might have been made, if the goods are within the State —

(i) in the case of specific or ascertained goods, at the time the contract of sale or purchase is made; and

(ii) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale or purchase by the seller or by the purchaser, whether the assent of the other party is prior or subsequent to such appropriation.

(b) Where there is a single contract of sale or purchase of goods, situated at more places than one, the provisions of clause (a) shall apply as if there were separate contracts in respect of the goods at each of such places.

Explanation-VI- Notwithstanding anything to the contrary contained in this Act, two independent sales or purchases shall, for the purposes of this Act, be deemedto have taken place —

(a) when the goods are transferred from a principal to his selling agent and from the selling agent to the purchaser, or

(b) when the goods are transferred from the seller to a buying agent and from the buying agent to his principal, if the agent is found in either of the cases aforesaid-

(i) to have sold the goods at one rate and to have passed on the sale proceeds to his principal at another rate, or

(ii) to have purchased the goods at one rate and to have passed them on to his principal at another rate, or

(iii) not to have accounted to his principal for the entire collections or deductions made by him in the sales or purchases effected by him on behalf of his principal;

2 (38) "Schedule" means the Schedule appended to this Act.

2 (39) "Special Additional Tax" means a tax levied or leviable under sub-section (4) of section 3, which shall not be entitled to input tax credit.

2 (49) "value added tax" means a tax on sale of goods at every point in the series of sales by the registered dealer with the provision of credit of input tax paid or payable at the previous point of purchase thereof;

2 (50) "value of goods" means the value as ascertained from the purchase invoice or bills and includes insurance charges, excise duties, countervailing duties, transport charges, freight charges and all other charges incidental to the transaction of the goods;

2 (51) "year" means the financial year;

2 (52) "works contract" includes any agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning, of any movable or immovable property;

2 (53) "zero rate sale" means a sale of any goods on which no tax is chargeable but credit for the input tax related to that sale is admissible.

Levy of taxes on sales of goods

3 (1) Every dealer, whose total turnover is not less than rupees three lakhs, for a year, shall pay a tax, on every sale made by him within the State, at the rate specified in the First Schedule.

3 (2) The tax payable under sub-section (1) by a registered dealer shall be reduced, in the manner prescribed, to the extent of tax paid on his purchase of goods specified in Parts A and B of the First Schedule, inside the State, to the registered dealer, who sold the goods to him:

Provided that the manufacturer in sugar shall not be entitled to input tax credit on the last purchase of sugarcane:

Provided further that the manufacturer or processor in gold, platinum and silver jewellery including articles thereof or bullion or precious stones, shall not be entitled to input tax credit on the tax paid or payable on purchases of such goods.

3 (3) Notwithstanding anything contained in sub-section (1), every dealer, who effects second and subsequent sales of goods purchased within the State to persons other than dealers and whose total turnover, for a year, is less than rupees ten lakhs, may, at his option, instead of paying tax under sub-section (1), pay a tax, for each year, on his total turnover at such rate not exceeding two per cent, as may be notified by the Government:

Provided that such dealer shall not be entitled to input tax credit on goods purchased by him.

3 (4) Notwithstanding anything contained in sub-section (1), every dealer, who deals in the goods specified in the Second Schedule, shall pay a tax and Special Additional Tax, for each year, on the sale of such goods, at the point and at the rate specified therein:

Provided that the dealer, who pay tax under this sub-section, shall not be entitled to input tax credit on goods purchased by him.

3 (5) When goods are sold together with containers or packing materials, the rate of tax applicable to such containers or packing materials, as the case may be, shall, whether the price of the containers or packing materials is charged separately or not, be the same as those applicable to the goods contained or packed and the turnover in respect of containers and packing materials shall be included in the turnover of such goods.

3 (6) Where the sale of goods, packed in any container or packed in any packing material, in which such goods are packed, is exempt from tax, then the sale of such containers or packing materials shall also be exempt from tax.

Levy of tax on right to use any goods

4 (1) Notwithstanding anything contained in this Act, every dealer, whose total turnover for a year is not less than rupees three lakhs, shall pay, for each year, a tax on his total turnover relating to the business of transfer of right to use any goods for any purpose, at such rate not exceeding twenty per cent of the taxable turnover, as may be notified by the Government

4 (2) The taxable turnover of the dealer of the business of transfer of the right to use any goods for any purpose, shall be arrived at after deducting all amounts, for which any goods specified in Parts A and B of the First Schedule are purchased from registered dealers liable to pay tax under this Act and used in the same form in the transfer of the right to use such goods for any purpose, from the total turnover of that dealer.

4 (3) The dealer, who pays tax under this section, shall not be entitled to input tax credit on goods purchased by him.

Levy of tax on transfer of goods involved in works contract

5 (1) Notwithstanding anything contained in this Act, every dealer, whose total turnover, for a year, is not less than rupees three lakhs, shall pay, for each year, a tax on his taxable turnover of transfer of property in goods involved in the execution of works contract, at such rate not exceeding twenty per cent of the taxable turnover, as may be notified by the Government.

5 (2) The taxable turnover of the dealer of transfer of property in goods involved in the execution of works contract shall be arrived at after deducting the following amounts from the total turnover of that dealer:-

(a) all amounts involved in respect of goods involved in the execution of works contract, in the course of export of the goods out of the territory of India, or in the course of import of the goods into the territory of India, or in the course of inter-State trade or commerce;

(b) all amounts for which any goods specified in Parts A and B of the First Schedule are purchased from registered dealers liable to pay tax under this Act and used in the execution of works contract in the same form in which such goods were purchased;

(c) all amounts relating to the sale of any goods involved in the execution of works contract which are specifically exempted from tax under this Act;

(d) all amounts towards 'labour charges and other like charges' not involving any transfer of property in goods, actually incurred in connection with the execution of works contract, or such amounts calculated at the rate specified in column (3) of the Table below, if they are not ascertainable from the books of accounts maintained and produced by a dealer before the assessing authority.

THE TABLE

Sl. No.	Type of works contract	Labour or other charges as a percentage value of the works contract.
1	Electrical Contracts	15
2	All structural contracts	15
3	Sanitary contracts	25
4	Watch and / or clock repair contracts	50
5	Dyeing contracts	50
6	All other contracts	30

(e) all amounts including the tax collected from the customer, refunded to the customer or adjusted towards any amount payable by the customer, in respect of unexecuted portion of works contract based on the corrections on account of measurements or check measurements, subject to the conditions that—

(i) the turnover was included in the return and tax paid; and

(ii) the amount including the tax collected from the customer, is so refunded or adjusted, within a period of six months from the due date for filing of the return in which the said amount was included and tax paid.

5 (3) The dealer, who pays tax under this section, shall not be entitled to input tax credit on goods purchased by him.

Levy of tax on food and drinks

6 (1) Notwithstanding anything contained in this Act, every dealer whose total turnover is not less than rupees ten lakhs, for a year, shall pay tax on the sale of ready to eat unbranded foods including sweets, savories, unbranded non-alcoholic drinks and beverages served in or catered indoors or outdoors by hotels, restaurants, sweet-stalls, clubs, caterers and any other eating houses, at such rate not exceeding twelve and half per cent of the taxable turnover, as may be notified by the Government.

Explanation-I - For the purpose of computing the total turnover under this sub-section, the purchase turnover liable to tax under section 12 of this Act, shall be added to the sales turnover.

***Explanation*-II**– For the purpose of computing the total turnover under this sub-section, the sales turnover of all business units in a common premises sharing the common kitchen or common employees shall be added to the sales turnover of the business unit having higher turnover.

6 (2) The dealer, who pays tax under this section, shall not be entitled to input tax credit on goods purchased by him.

Payment of tax at compound rate by hotels, restaurants and sweet-stalls

7 (1) Notwithstanding anything contained in sub-section (1) of section 6, every dealer whose total turnover is not less than rupees ten lakhs but not more than rupees fifty lakhs for the year on the sale of ready to eat unbranded foods including sweets, savories, unbranded non-alcoholic drinks and beverages served in or catered indoors or outdoors by hotels, restaurants, sweet-stalls, clubs, caterers and any other eating houses, may, at his option, instead of paying tax in accordance with the provisions of sub-section (1) of section 6, pay tax at the rate specified in Part A of the Third Schedule.

Explanation. – For the purpose of computing the total turnover under this sub-section, the purchase turnover liable to tax under section 12 shall be added to the sales turnover.

7 (2) Every dealer, who opts for payment of tax under sub-section (1), shall apply to the assessing authority in such form as may be prescribed, on or before the 30th day of April of the year or within thirty days of commencement of business, as the case may be, and shall pay tax in advance during the year in monthly instalments and for this purpose, he shall furnish such return, within such period and in such manner, as may be prescribed.

7 (3) The option so exercised under sub-section (2) shall be final for that year and shall continue for subsequent years until the dealer becomes ineligible or withdraws his option in writing.

7 (4) A dealer liable to pay tax under sub-section (1) shall not collect any amount by way of tax or purporting to be by way of tax on the sale of food and drinks.

7 (5) The dealer, who pays tax under this section, shall not be entitled to input tax credit on goods purchased by him.

Levy of tax on bullion and jewellery

8 (1) Notwithstanding anything contained in this Act,-

(a) every dealer in bullion, whatever be his turnover for the year, shall pay a tax at the rate specified in Part C of the First Schedule;

(b) every dealer in precious stones, gold, platinum and silver jewellery including articles thereof, whatever be his turnover for the year, shall pay tax at the rate specified in Part A of the First Schedule.

8 (2) The dealer, who pays tax under this section, shall not be entitled to input tax credit on goods purchased by him.

Levy of tax on Sugarcane

10 (1) Notwithstanding anything contained in this Act, every dealer shall pay a tax on the last purchase of sugarcane, excluding sugarcane setts, in the State, at the rate specified in Part D of the First Schedule.

Levy of Purchase Tax

11. Every dealer, who in the course of his business purchases, from a registered dealer, any goods (the sale or purchase of which is liable to tax under this Act), in circumstances in which no tax is payable by that registered dealer on the sale price of such goods under section 3, or from any other person, shall be liable to pay tax on the purchase price of such goods, if after such purchase, the goods are not sold within the State or in the course of inter-State trade and commerce or in the course of export out of the territory of India, but are -

(a) sold or disposed of otherwise; or

(b) consumes or uses such goods in or for the manufacture of other goods for sale or otherwise; or

(c) disposes of such goods in any manner other than by way of sale in the State; or

(d) despatches or carries them to a place outside the State except as a direct result of sale or purchase in the course of inter-State trade or commerce;

(e) instals and uses such goods in the factory for the manufacture of any goods,

and such tax shall be levied at the same rate at which tax under section 3 would have been levied on the sale of such goods within the State on the date of such purchase.

Deduction of tax at source in works contract

12 (1) Notwithstanding anything contained in this Act, every person responsible for paying any sum to any dealer for execution of works contract shall, at the time of payment of such sum, deduct an amount calculated, at the following rate, namely:-

(i) **Civil works contract** : Two per cent of the total amount payable to such dealer:

(ii) **All other works contracts** : Four per cent of the total amount payable to such dealers:

Provided that no deduction under sub-section (1) shall be made where —

(a) no transfer of property in goods (whether as goods or in some other form) is involved in the execution of such works contract; or

(b) the dealer produces a certificate in such form as may be prescribed from the assessing authority concerned that he has no liability to pay or has paid the tax under section 5:

Provided further that no such deduction shall be made under this section, where the amount or the aggregate of the amount paid or credited or likely to be paid or credited, during the year, by such person to the dealer for execution of the works contract including civil works contract does not or is not likely to, exceed rupees one lakh.

Explanation— For the purpose of this section –

(a) the term ' person' shall include –

(i) the Central or a State Government;

(ii) a local authority;

(iii) a corporation or body established by or under a Central or State Act;

(iv) a company incorporated under the Companies Act, 1956 including a Central or State Government undertaking;

(v) a society including a Co-operative Society;

(vi) an educational institution; or

(vii) a trust;

(b) the term "civil works contract" means civil works of construction of new building, bridge, road, runway, dam or canal including any lining, tiling, painting or decorating which is an inherent part of the new construction; but shall not include any repair, maintenance, improvement or upgradation of such civil work by means of fixing and laying of all kinds of floor tiles, mosaic tiles, slabs, stones, marbles, glazed tiles, painting, polishing, partition, wall panelling, interior decoration, false ceiling, carpeting and extra fittings, or any manner of improvement on an existing structure.

12 (2) Any person making such deduction shall deposit the sum so deducted to such authority, in such manner and within such time, as may be prescribed.

12 ((3) Any person who makes the deduction and deposit, shall within fifteen days of such deposit, issue to the same dealer a certificate in the prescribed form for each deduction separately, and send a copy of the certificate of deduction to the assessing authority, having jurisdiction over the said dealer together with such documents, as may be prescribed.

12 (4) On furnishing a certificate of deduction referred to in sub-section (3), the amount deposited under sub-section (2), shall be adjusted by the assessing authority towards tax liability of the dealer under section 5, as the case may be, and shall constitute a good and sufficient discharge of the liability of the person making deduction to the extent of the amount deposited:

Provided that the burden of proving that the tax on such works contract has already been deposited and of establishing the exact quantum of tax so deposited shall be on the dealer claiming the deduction.

12 (5) Any person who contravenes the provisions of sub-section (1) or sub-section (2), shall pay, in addition to the amount required to be deducted and deposited, interest at two per cent per month of such amount for the entire period of default.

12 (6) Where the dealer proves to the satisfaction of the assessing authority that he is not liable to pay tax under section 5, the assessing authority shall refund the amount deposited under sub-section (2), after adjusting the arrears of tax, if any, due from the dealer, in such manner as may be prescribed.

12 (7) The tax or interest under this section shall become due without any notice of demand on the date of accrual for the payment by the person as provided under sub-sections (1) and (2).

12 (8) If any person contravenes the provisions of sub-section (1) or sub-section (2), the whole amount of tax payable shall be recovered from such person and all provisions of this Act for the recovery of tax including those relating to levy of penalty and interest shall apply, as if the person is an assessee for the purpose of this Act.

Reversal of tax credit

13. Where a dealer has refunded the price of the goods returned by customers together with the tax collected from such customers in respect of the sale of such goods and where the amount representing the price refunded by the dealer is included in his turnover, or where the goods sold are returned for the reason that they were not taken delivery of by the person to whom they were intended, the dealer shall be entitled to reversal of input tax paid by him on such goods return or unfructified sale, as the case may be, subject to the conditions as may be prescribed.

Exempted sale

14. Sale of goods specified in the Fourth Schedule by any dealer is exempt from tax.

Stage of levy of taxes in respect of imported and exported goods.

15 (1) In the case of goods imported into the State either from outside the territory of India or from any other State, the stage of levy of tax shall be deemed to commence at the stage of the sale effected immediately after the import of such goods;

15 (2) In the case of goods exported out of the State to any place outside the territory of India or to any other State, the stage of levy of tax shall be deemed to conclude at the stage of sale effected immediately before the export of such goods:

Provided that in the case of goods exported out of the State to any place outside the territory of India, where the sale or purchase effected immediately before the export of such goods is under sub-section (3) of section 5 of the Central Sales Tax Act, 1956, a sale or purchase in the course of export, the series of sales or purchases of such goods shall be deemed to conclude at the stage of the sale or purchase immediately preceding such sale or purchase in the course of export.

Burden of Proof

16 (1) For the purpose of assessment of tax under this Act, the burden of proving that any transaction or any turnover of a dealer is not liable to tax, shall lie on such dealer.

16 (2) For the purpose of claim of input tax credit under sub-section (2) of section 3 or reversal of tax credit under section 13, the burden of proving such claim shall lie on such dealer.

16 (3) Notwithstanding anything contained in this Act or in any other law for the time being in force, a dealer in any of the goods liable to tax in respect of the sale in the State shall be deemed to be the first seller of such goods and shall be liable to pay tax accordingly on his turnover of sale relating to such goods, unless he proves that the sale of such goods had already been subjected to tax under this Act.

16 (4) Where any dealer produces a false bill, vouchers, claim of input tax credit or refund or other documents with a view to support his claim, the assessing authority shall on detecting such production direct the dealer producing such document to pay as penalty a sum-

(i) which shall be in the case of first such detection fifty per cent of the tax due in respect of such claim; and

(ii) which shall be in the case of second or subsequent detections one hundred per cent of the tax due in respect of such claim:

Provided that no penalty shall be levied without giving the dealer a reasonable opportunity to show cause against such imposition.

Zero Rating

17 (1) A sale as specified under sub-section (1) of section 5 of the Central Sales Tax Act, 1956 shall be zero rate sale.

17 (2) Sale of any goods to international organisations listed out in the Fifth Schedule shall be deemed to be sale of goods in the course of export outside the territory of India, which shall be zero rate sale.

17 (3) The dealer, who makes zero rate sale, shall be entitled to a refund of tax paid or payable by him on purchase of such goods, in any form, which is so exported, subject to such restrictions and conditions as may be prescribed.

17 (4) Where the dealer has not adjusted the input tax credit relating to zero rate sale against any tax payable by him or has not made a claim for refund within a period of one hundred and eighty days from the date of accrual of such input tax credit or before the closure of the next financial year, whichever is later, such credit will stand lapsed to the Government.

Input tax credit

18 (2) (d) sale in the course of inter-State trade or commence to the Registered dealer under the Central Sales Tax Act, 1956:

Provided that in respect of sale in the course of inter-

State trade or commerce, the input tax credit shall be reduced to such extent, as may be notified by the Government, which shall not exceed four per cent of tax paid or payable on sale of such goods in the course of inter-State trade or commerce under the Central Sales Tax, 1956.

18 (4) (a) The registered dealer shall not claim input tax credit until the dealer receives an original invoice duly filled, signed and issued by a registered dealer from whom the goods are purchased, containing such particulars, as may be prescribed, of the sale evidencing the amount of input tax.

18 (4) (b) Where the tax amount is not indicated specifically in such invoice, the input tax amount shall be determined by reduction of such amount from the invoice by adopting the tax fraction formula as may be prescribed.

18 (4) (c) If the original invoice is lost, input tax credit shall be allowed only on the basis of a duplicate carbon copy of the invoice obtained from the selling dealer subject to such conditions as may be prescribed:

18 (5) (c) No input tax credit shall be allowed on tax paid or payable in the State on purchase of goods—

(i) for transfer to a place outside the State otherwise than by way of sale; or

(ii) for use in manufacture of other goods and transfer to a place outside the State either by branch transfer or transfer to an agent, by whatever name called, for sale, or in any other manner, except as a direct result of sale or purchase in the course of inter-State trade or commerce:

18 (11) (d) No input tax credit shall be allowed on purchase of capital goods, which are used exclusively in the manufacture of exempted goods specified in the Fourth Schedule.

18 (11) (e) No input tax credit shall be allowed on goods acquired on lease or hire purchase agreement basis from a financing company.

18 (12) Where a dealer has availed credit on inputs and when the finished goods becomes exempt, credit availed on inputs used therein, shall be disallowed and reversal of tax credit shall be made**.**

18 (18) Where the business of a registered dealer is transferred on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of the business to a joint venture with the specific provision for transfer of liabilities of such business, then, the registered dealer shall be entitled to transfer the input tax credit lying unutilised in his accounts to such transferred, sold, merged, leased or amalgamated concern. The transfer of input tax credit shall be allowed only if the stock of inputs, as such, or in process, or the capital goods is also transferred to the new ownership on which credit has been availed of are duly accounted for, subject to the satisfaction of the assessing authority.

18 (19) Where a registered dealer has purchased any taxable goods from another dealer and has availed input tax credit in respect of the said goods and if the registration certificate of the selling dealer is cancelled by the appropriate registering authority, such registered dealer, who has availed by way of input tax credit, shall pay the amount availed on the date from which the order of cancellation of the registration certificate takes effect. Such dealer shall be liable to pay, in addition to the amount due, interest at the rate of two per cent, per month, on the amount of tax so payable, for the period commencing from the date of disposal of the goods to the date of its payment.

Chapter - 8

Administration of VAT

GOALS AND BASIC REQUIREMENTS OF VAT ADMINISTRATION

The issues in VAT administration can be discussed in the context of goals of tax administration. The major goals of tax administration are to:

- promote voluntary tax compliance;
- identify defaulters;
- enforce penalties on defaulters; and
- keep low the cost of administration and compliance.

Promoting voluntary tax compliance would ensure that tax is effectively enforced with the least possible leakage of revenue. The administration cannot follow up every taxpayer for enforcing the tax laws. It is neither economical nor feasible. There should be an appropriate tax structure and simple procedures and forms to facilitate, encourage, and induce voluntary compliance. The tax administration is required to establish systems to identify persons who indulge in non-compliance and enforce deterrent penalties on them. Enforcement of the tax laws imposes costs on taxpayers as well as administration. This cost is a deadweight loss for the economy and, hence, should be kept to the minimum possible.

Basic requirements for administering a VAT

The basic requirements for successful implementation of a VAT include the following:

- a suitable tax structure compatible with voluntary tax compliance;
- an appropriate system for registration and taxpayer identification;
- a suitable system of invoicing and bookkeeping;
- a simple tax collection and verification mechanism;
- a system for obtaining third-party information such as on trade flows, and performance and input-output ratios by industry or broad commodity groups;
- an enforcement system with strategies to deal with different kinds of non-compliance;
- a system for identifying unregistered potential taxpayers;
- a sound and effectively enforceable penalty system;
- a mechanism to use successful cases as means of promoting voluntary compliance;
- a reliable electronic data processing (EDP) system;
- a system for selection, training and suitable placement of staff; and
- a system of rewarding performance accompanied by a system of punishing non-performance.

These requirements are briefly dealt with in the following sections.

TAX SYSTEM AND VOLUNTARY COMPLIANCE

The tax structure and administrative procedures and strategies should be so designed that they encourage voluntary compliance. Some of the factors, which contribute to voluntary compliance and hence should be kept in mind in designing the tax structure and administrative procedures and strategies, are:

- simplicity of the tax structure;
- reasonable level of taxation;
- equity in taxation;
- simplicity of administrative procedures;
- adequacy of taxpayer education programmes;
- adequacy of taxpayer services; and
- credibility of tax administration.

The most important requirement in the Indian context is a complete change in the attitude of the tax administrators. The tax administrators should act as public servants and should always be helpful to the taxpayers in accordance with the law. Taxpayers should be treated with respect as contributors. The administrative procedures should be such that there is very little direct contact between the taxpayers and the tax officials.

The credibility of tax administration is perceived also in terms of its capacity to identify defaulters and enforce penalties. The enforcement strategies should be such that the taxpayers perceive a credible threat that the tax administration would be able to detect and enforce penalties on them should they indulge in tax evasion. The ethics of tax officials are as important as enforcement strategies in building the credibility of tax administration.

REGISTRATION AND TAXPAYER IDENTIFICATION

Registration of all taxable persons is a must for successful implementation of a tax. The VAT Act should clearly indicate:

- who is required to register?
- how and where to register?
- from where to obtain and where to submit the registration form?
- what information is to be furnished at the time of registration? and what are the obligations and privileges of registered taxpayers?

An easy access to all this information encourages voluntary tax compliance. In addition, the following provisions would also aid voluntary compliance.

A person whose yearly sales of taxable goods (and services) exceed or are expected exceed a specified threshold should be required to apply for registration on a prescribed application form at the specified registration centre (a model application form is given in chart).

Voluntary registration by a person with annual sales not exceeding the threshold should be allowed, if requested for trade reasons such as, to issue tax invoices for selling goods to registered persons or to obtain a VAT refund on exports.

Only registered persons should be allowed to issue tax invoices and avail of credit for VAT paid on their purchases.

A person who becomes liable to be registered for VAT during a year, but tails to register, should also be liable to pay VAT on his taxable sales.

Registered person should be required to display his registration certificate at his principal place of business and copies of the certificate at all other places of his business.

A registered person should be required to notify the tax administration, within a specified time, of any change affecting the details shown in the registration certificate or in the application form for registration.

A registered person, irrespective of his level of sales, should be required to comply with all the tax provisions including maintaining records, paying tax and filing tax returns, until his name is removed from the register.

Measures to promote registration

The tax administration must take the following steps for facilitating registration by potential registrants:

- adequate publicity;
- mailing blank application forms to potential registrants;
- efficient taxpayer services to respond to taxpayer queries;
- setting up registration counters in major business centres for about a week, every year; and
- educational visits by tax officials to some potential registrants.

Adequate publicity through notices, booklets, and television and newspaper advertisements is necessary to ensure that all persons who must register know that they should do so and know how and where to obtain application forms and other information. Blank application forms and leaflets outlining the VAT should be made available at a low price. In the tax administration offices, trained staff should be available for explaining the VAT structure and the legal obligations of persons in business. Outstanding publicity campaigns along these lines have been successfully implemented, for example, in Korea, Malaysia, Mexico, New Zealand, and Taiwan.

In India, generally, registration is treated as a privilege, though it is an obligation. A person seeking registration has to satisfy many conditions, such as, giving sureties and bank guarantees. Such conditions should not be imposed for registration under VAT, if voluntary compliance is to be encouraged. In this respect, rightly, the “Model Statute for VAT’ prepared by NIPFP does not propose the imposition of any such condition for registration under VAT. Further, in some cases, there are inordinate delays in granting registration. Setting a time limit for granting registration after the filing of application for registration can go a long way in encouraging voluntary compliance.

The management information system should be such that every new registration would be immediately reported to the computer centre. Steps should be immediately taken to verify that the new registrant has a genuine business and is a dealer. Once taxpayers are registered, the staff should make brief familiarisation visits to newly registered taxpayers. Priority should be given to those who have not previously paid any other type of sales tax or where there appears to be substantial revenue risk (e.g., large taxpayers). Visits should also be made to those identified as potential VAT taxpayers who have not yet been registered.

The educational visits serve a number of purposes, such as:

- confirming that the registered person is a taxable person by reason of turnover or, if below limit, that he has valid trade reasons for requiring registration;
- confirming the accuracy of the registered person's name, address, and telephone number;
- confirming that the self-assigned economic activity code is correct;
- checking that the taxpayer's accounting system is satisfactory and that he knows how to issue invoices fulfilling all VAT requirements when selling to VAT payers or final consumers (non-VAT payers); and
- checking that the taxpayer knows how to account for his output and input tax so that he can make timely and accurate tax returns.

During educational visits, the tax administration staff should try to understand individual traders problems and help them. This is very important for the successful launching and administration of VAT. If the tax official finds evidence of late registration, he should explain its implications to the dealer, such as that the dealer is liable to pay VAT on all taxable sales made between the date of application of VAT as per the legal provisions and the date of submitting the application for registration.

Allotment of taxpayer identification number (TIN)

Each taxpayer should be assigned a unique taxpayer identification number (TIN). A TIN is a code to identify a taxpayer. It has two main objectives: (i) to facilitate computer applications, such as detecting stopfilers and delinquent accounts; and (ii) to help cross-check information on taxpayer compliance, for example, the selective cross-checking of sales and purchases among VAT taxpayers.

A TIN should comprise four parts: (i) the state code, (ii) a biographical character, (iii) a sequential number and (iv) a check digit. The state code is required to indicate the state to which the taxpayer belongs. The biographical character of a taxpayer should be assigned according to some unchanged characteristics of the taxpayer such as the date and/or place of birth. The sequential number is assigned in the order of registration. It also gives a count of the number of taxpayers. The check digit for a taxpayer is calculated according to a secret mathematical formula to detect errors in the reporting of TIN. The check digit could simply be the numeric sum of the digits in the first and third parts of the TIN, divided by nine. Each state should allot the TIN centrally and maintain a taxpayer identification master file. Certain other characteristics that a TIN should satisfy are given below:

- Each taxpayer must be given a unique and reliable TIN. A unique TIN if applied to all taxes would facilitate cross verification across tax departments.
- The TIN should not include taxpayer characteristics that may change over time such as economic activity, type (natural person or a legal entity), and location (address) of the taxpayer within the state. Inclusion of such characteristics creates problems, because a change in such a characteristic of the taxpayer would call for a change in his TIN.
- Each company (including its branches within the state) should be assigned only one TIN. For conglomerates, a separate TIN should be assigned to each separate legal entity.
- The TIN should be only as long as is necessary for identifying taxpayers. Eleven digits are sufficient to identify the entire world population.
- In the composition of TIN, use of alphanumeric characters should be avoided. Some computer devices cannot process alphanumeric inputs. Also, alphanumeric keyboards slow down keying in information and increase the chances of error. Use of the letters "I" and "0" of the English alphabet gives rise to additional problem, because they are easily confused with the numbers "1" and "0"

Economic activity code

Knowledge about economic activity codes of taxpayers is useful in producing statistical information for economic analysis, evaluating performance of the tax system and auditing the taxpayers. Each taxpayer should be assigned an economic activity code that should be recorded in the taxpayers' master file. The tax administration should provide a table of economic activity codes. A taxpayer should assign to himself an economic activity code based on the table of codes at the time of registration. The code of each large taxpayer should be reviewed, however, preferably at the initial familiarisation visit, since an incorrect use of a code by a large taxpayer could cause serious statistical distortions. VAT registration forms should require a written description of the business as well as the numeric code. This information should be recorded. The computer must produce a list of taxpayers containing name, economic activity code and the written description of the business activity provided by the taxpayer, so that any major discrepancy can be quickly noticed by the tax officials reviewing the economic activity code.

For assigning codes to different economic activities, it is advisable to follow the codification structure of the International Standard Industrial Classification (ISIC). This facilitates comparison of tax statistics with the national accounts and with international statistics. The ISIC uses only Arabic numbers. The numbers used to identify divisions and groups are arranged according to a decimal system. Therefore, the ISIC code can be expanded or reduced without changing the basic system. An economic activity code with approximately three hundred different groups is sufficient to cover all relevant economic activities.

INVOICE REQUIREMENTS

There are two types of invoices: tax invoices and final consumer invoices. The tax invoices are required to register sales and purchases among the VAT taxpayers, while the final consumer invoices are used to register sales to unregistered persons (final consumers).

Tax invoice

The tax invoices are crucial for VAT control. They establish both the tax liability of the seller and the amount of the deduction allowed to the registered purchaser. A tax invoice should be issued only by the VAT taxpayers and it should contain the following information:

- name, address and VAT-registration number of the seller;
- date of issue of the invoice;
- serial number of the invoice;
- quantity and description of the goods (and services) sold;
- unit price and the amount charged (excluding VAT);
- VAT charged; and
- name, address, and VAT-registration number of the buyer.

The tax invoice should be produced in triplicate. The original and the first copy of the tax invoice must be given to the purchaser. The original is for his record to support his credit claim on a deductible input. The first copy should be made available to the tax administration, when requested to do so, for cross-verification of sales reported by sellers and purchases reported by buyers for which tax credit has been availed of by the buyers.

The second copy should be retained by the seller. To avoid any misuse of first and second copies of the tax invoice, these should be marked as "this copy does not entitle the holder to a tax credit". Further, colour of copies of invoice should be made different from that of the original for easy identification. Carbonless copies avoid certain types of mistakes. Chart 2 gives a model tax invoice.

Final consumer invoice

This is a simplified type of invoice for registering sales to unregistered persons who should be considered final consumers under the VAT. On this invoice, the price may be shown inclusive of VAT, while the name and address of the buyer may be omitted. Only one copy of the invoice is necessary.

BOOK KEEPING REQUIREMENTS

In general, the VAT law should prescribe a minimum number of records to be kept. These records, books, and accounts should be kept updated and be available for inspection at any time.

Since preserving the old records involves costs, these should be required to be preserved only for a short period. In the context of India, these may be required to be preserved initially for a period of seven years. The period may be reduced to five years on gaining experience in the administration of VAT.

Every VAT-registered person should keep records of all tax invoices they issue and receive, including the serial number and the date of the invoice, the amount charged, and the VAT charged.

Book keeping requirements would slightly differ if the subtraction method rather than the generally adopted tax credit method is followed for computing VAT. With the subtraction method, there is no need to have a separate account for the amount of tax charged or paid in addition to the total amount charged or paid.

The records should be kept in specifically designed purchase and sales books. Book keeping should be integrated with the return form so that entries in the latter are directly carried from the former. An illustration of working of VAT that clarifies requirements for keeping books of account is given in chart 3.

Purchase book of accounts

A model format for the purchase book of accounts is given in chart 4. The purchase book should have provision for recording the following information:

- tax-exempt and taxable purchases, separately;
- imports and domestic purchases, separately;
- purchases subject to different VAT rates, separately; and
- the date, invoice number, name of the supplier, TIN of the domestic supplier, value of purchases and VAT credit.

Sales book of accounts

A model format for the sales book of accounts is given in chart 5. The sales book should have provision for recording the following information:

- exempt sales, zero rated sales, and sales subject to different VAT rates, separately;
- sales to registered taxpayers and final consumers, separately; and
- the date, invoice number, name and TIN of the buyer, value of sales and VAT charged, if the buyer is a registered taxpayer. Name and TIN of the buyer are not needed, if the buyer is an unregistered taxpayer.

Credit notes

Where credit notes are issued, they should contain the same information as the tax invoices and, in addition, the date and serial number of the tax invoice on which the VAT was originally charged and brought to account, and the reason for giving the credit. However, for credit notes issued to clear the books of bad debts, no credit for VAT should be allowed in the VAT accounts.

TAX COLLECTION AND VERIFICATION

Generally, tax administrations are organised along functional lines reflecting four main functions (i) taxpayer information and registration; (ii) tax accounting and data processing; (iii) tax collections (pursuing stopfilers and delinquent accounts); and (iv) audit (inspection and control). The collection division is concerned mainly with (i) the payment of tax and the filing of returns by registered persons; and (ii) identification of non-filers, stopfilers and delinquent taxpayers. This involves setting a schedule of payment of tax and filing of tax returns, tax accounting (verification of actual payment of tax with declared payment etc.), issuing refunds, collection of VAT by customs department on imports by unregistered persons (if any), and identification of non-filers, stop-filers and delinquent taxpayers. A brief discussion on these aspects follows.

Schedule of payment of tax and filing of returns

The VAT Act should specify the periodicity of payment of tax and filing of tax returns. It could be monthly for large and medium taxpayers, and quarterly for small taxpayers. This facilitates a smooth flow of revenue to the government, and allows getting around the defaulters within a short period without giving them an opportunity to gather large amounts and become defunct.

The monthly or quarterly return should be simple, and it should call for only limited information. In fact, it can be combined with the payment form as illustrated in the model VAT form in chart 6. The annual return, however, should call for additional information such as purchases and sales by various rate categories (exempt, zero rated, and subject to different VAT rates), imports domestic purchases, and sales to and purchases from registered and unregistered persons.

For taxpayers' convenience, provision should be made for accepting the tax returns and payment of tax at certain authorised banks and post offices, in addition to the tax offices. This would be tantamount to "privatisation" of tax collection. Banks are used for collecting VAT in a number of countries including Argentina, Brazil, Italy, Japan, Mexico, Portugal, and Spain. (Banks are used also for collecting Income Tax in a number of countries including India). Their experience in this regard has generally been good as banks are used to handling financial transactions.

Taxpayers should submit VAT returns to an authorised bank or the post office in the area where they are registered. The collecting agency should be required not only to accept VAT returns with payment of VAT but also the VAT returns with no payment of VAT (i.e., excess credit returns, returns reporting no operations, or returns not accompanied by the full amount of the tax due). At the time of accepting the return, TIN should be verified with the identity card of the taxpayer which is to be issued at the time of registration.

The VAT return should be filed in triplicate on a carbonless copy paper, which is easier to complete and avoids certain types of mistakes. The recipient should stamp and sign the return form. The original should be given to the taxpayer. The first copy should be sent to the tax administration along with the statement of tax collected. The second copy can be retained by the collecting agency like the bank till the accounts are settled.

The collecting agencies should be required to send the return forms to the tax administration within ten days of receiving them. The return forms should be processed by the collecting agency, in batches of, say 50 (except those in the last batch of the day, which may be less than 50). Each batch should be accompanied by a batch control sheet (BCS), and each BCS should be numbered consecutively by the branch. The BCS should contain the name of the branch, number of the BCS, date, amount of the tax received, amount relating to bounced cheques (if any), amount of excess credit declared corresponding to the tax returns in the batch, and the number of tax returns included in the batch.

There should be a payment of fee to the banks/post-offices for rendering the service of collecting tax and the return forms. It could be in the form of:

- a fixed amount per tax return;
- a percentage of tax collected;
- leaving the tax collected with the collecting agency, for a specified period before transferring it to the government; or a combination of two or more of the above-mentioned forms of payment.

Accounting of tax payments

The basic accounting unit should be the batch. In a batch, the declared amount actually paid must tally with the total amount of cash, cheques, or certificates used to settle the liability. A sub-system should be set up to deal with the cheques that bounce. A list of bounced cheques should be prepared and action taken within a short period. In some cases, a telephone call may be sufficient to real is the amount due.

The total amount of tax collected by the collecting agencies, as shown in the batches received by the tax administration, should be compared with the collection remittance report submitted by the collecting agency. The tax amount may be credited directly or periodically to the account of the tax department that should be maintained with the concerned collecting agency.

Refunds

In developing countries, a VAT refund poses special problems because in these countries the legal and administrative framework is such that the tax officials are reluctant to give the refund. Taxpayers often have to comply with tortuous procedures to obtain the refund.

Practically all developing countries give VAT refunds to exporters. A growing number of such countries, however, require other VAT taxpayers to carry forward their excess credits indefinitely or until the end of the calendar or financial year. Thus, for example, in Philippines and Taiwan, refunds of excess credits are granted only to the taxpayers making zero rated sales, or if the excess credit originates from the purchase of capital assets; other excess credits are permitted to be carried forward until fully absorbed. This reduces the workload of the administration and allows it to concentrate on more productive tasks. For the Indian states, it would be advisable to refund periodically the excess credit originating from zero rated sales, and permit carry forward in other cases. As the VAT yield stabilises, it would be desirable to refund the latter as well, at the end of the financial year.

As regards refund to exporters, there is evidence of widespread abuse and fraud in developing countries. The authorities have to choose between unattractive alternatives in dealing with this problem. While on one hand, too intensive a check before issuing a refund will impair the competitive position of the exporter, on the other, if export refunds are not checked carefully, serious abuses may escape detection. Probably the best solution would be to give refunds automatically to the dealers with consistent and regular exports which can be verified later but the refunds to the traders with exceptional or irregular exports should be subject to prior validation of their claims. However, in the case of new businesses or traders just starting to export, careful checks (with delay, if need be) should be made.

Collection by the customs department

Under a central VAT, the customs administration can collect VAT on all imports. In most developing countries implementing central VAT, collection of VAT by customs represents a significant share of the VAT revenue. The relevant customs forms provide boxes for the calculation of VAT (where chargeable) and for the insertion of the importer's VAT registration number, if he is registered. The customs declaration form relates to VAT as well as to customs duties.

Under a state VAT, collection of VAT by the customs tax administration is not feasible, as the VAT rate(s) would generally differ across states, and there will be need to determine the destination state for the imported goods. Moreover, there is no compelling need for collecting state VAT at the point of import as long as import is by a manufacturer or trader registered for state VAT, because, in any case, it will be subject to a state VAT at the time of sale. Under the existing law, however, a state cannot impose a tax on imports. If consumers are allowed to import goods directly, this position might have to be reviewed.

Identification of stopfilers and delinquent taxpayers

The simplest way to identify and punish stopfilers and delinquent taxpayers is through quick and intensive action based on a computerised system. Most European countries, as well as many Latin American countries, rely heavily on computers for processing a large number of tax returns and detecting stopfilers or delinquent accounts promptly and reliably.

Computerised lists of stopfilers and delinquent accounts should be produced every month or quarter, as the case may be. Appropriate reminder letters should be printed by the computer and sent to the defaulters through the postal system, as a first step to enforce taxpayer compliance. After a reasonably short period of time, a second reminder should be sent to those who have yet not complied, warning them of legal prosecution in case noncompliance persists. Summaries of computer outputs should be given to the concerned assessing 'officials for follow up action. The same procedures should be followed for processing the VAT returns submitted late.

Payment of tax should not be a prerequisite for filing returns, although payment of interest and penalties for late payment in addition to the tax due should be collected by all legal means, without delay. The VAT return should show in a separate box the penalties paid by the taxpayer (see chart 6) so that the computer system can check them and report discrepancies, if any.

Taxpayers' compliance depends on the likelihood of being detected promptly by the tax administration and having the penalties enforced. The tax administration's actions against stopfilers or delinquent taxpayers should be swift, strong and costly enough for taxpayers, to persuade them to file the tax returns and make timely payments. Usually, taxpayers will fulfil their obligations if non-compliance results in additional net expenses to their businesses.

TAX RETURN FORM

Tax administrations use the tax return forms to obtain data from taxpayers for enforcing the tax laws and for economic analysis. In the case of VAT, the administration's ability to convert data promptly into usable information is a basic requirement. If the authorities cannot make use of the data promptly, the requests for information merely slow down the tax collection process. Simply being asked to supply information is not intimidating to taxpayers. Effective enforcement is the only way to improve voluntary compliance. Therefore, it is pointless to ask taxpayers to give full details about their sales and purchases as it would be impossible to process such information accurately within a reasonable time frame. Request should be made for information that is adequate and also can be processed rapidly.

The VAT return may be designed as a combined tax return and payment form. Chart 6 gives a model VAT return form for a typical VAT with two rates for domestic sales, exemptions, and zero rating of inter-state transactions and exports (Under a state VAT, inter-state sales should also be zero rated. Therefore, a provision is made in the return form for reporting interstate sales separately. Generally, these are subject to full tax in the destination state.) No special receipt need be issued when the return is submitted. The taxpayer should be given a stamped copy of the return along with signatures of the receiving official.

There is no need to ask for attachments to the return, although taxpayers must keep, in an orderly manner, supporting documentation for a period of 5-7 years. Also, taxpayers' records must be made available to the tax officials upon request.

The head office and, the branches of a firm located within a state should be treated as one taxable entity. Only one return, consolidating sales and purchases of the head office and branches, should be permitted for each registered taxpayer.

Forms printed on carbonless copy paper would be easier to complete, and certain types of falsification would be prevented through the use of such forms, as discussed earlier.

SYSTEM OF TAX ASSESSMENT

An assessment system that is conducive to a system of voluntary compliance is the self-assessment system that is the backbone of modern tax administrations.

Characteristics of a self-assessment system

Under a self-assessment system, a taxpayer is responsible for determining his own tax liability (self-assessment) and accurate and timely reporting and payment of his tax. Self-assessment places more responsibility on the taxpayers. There is no regular intervention by a tax official at the time the return is filed to check that each return is correct. Tax returns can be submitted directly to the bank, post-office, or tax-office. Accuracy of return forms is checked and notices printed for deficiency in payment of tax by the computer on the basis of information contained in the returns. A fraction (10 to 20 per cent) of taxpayers are audited to enforce compliance. This avoids frequent one-to-one contact of taxpayers with tax officials.

With a self-assessment system in place, tax officials need to spend less time on routine work and hence can devote more time to more productive activities like investigation of selected cases.

Requirements of a self-assessment system

A self-assessment system is a prime requirement. In order to make it a success and to protect revenues the following conditions are required:

- procedures must be simple;
- a strong but fair system of penalties must be applied to the defaulters; and effective audit and enforcement programmes must be introduced.

IDENTIFICATION OF TAX EVASION AND FRAUD

Tax evasion and tax frauds are practised by several taxpayers under any tax system including VAT. Under VAT, tax evasion may take place through over reporting of purchases, underreporting of sales and misclassification of sales or purchases. Tax fraud may take place through altering or counterfeiting documents. This goes beyond tax violations and falls into the realm of crime. Fraud should be punished even if there is no loss of revenue.

In India, a part of tax evasion may take place through virtual hiding of some transactions. Records of the dealers would be inadequate to track such evasion and third party information would be crucial here.

A specified amount of the resources of tax administration must be allocated to identify tax evaders and tax defrauders, and to enforce penalties on them. The purpose is not only to dissuade the violators so that they change their behaviour and not repeat the offence, but also to punish the offenders as an example to others.

The strategy to identify defaulters

The level of non-compliance with the tax laws depends mainly on the probability of detection and the severity of penalty. The way to increase probability of detecting and punishing VAT evaders is to develop a strategy based on broad and swift audit. The audit coverage should be as broad as possible and the probability of enforcing penalties on the defaulters should be high.

Recourse to search and seizure should be taken only on rare occasions. Such an action should be based on substantive evidence of a large scale evasion or fraud. Success rate in such cases should be about 100 per cent; otherwise, the credibility of tax administration is adversely affected.

Selection of taxpayers for audit

Audit should be selective but should cover all categories of taxpayers. Success of an audit programme depends, besides other factors, on the choice of cases for audit. A consideration of the following strategy will be useful for selection of cases for audit.

- Depending on the capacity of tax administration, 10 to 20 per cent of VAT taxpayers may be selected for audit.
- The larger cases, to the extent of 10 per cent of the total number of cases to be audited, should be included in the audit cases.
- About 75 per cent of the audit cases may be selected on the basis of risk analysis, that is, high-risk taxpayers. Risk analysis involves some mathematical formulae which assign risk-score to a taxpayer, based on his characteristics (such as the ratio of sales to purchases, the ratio of sales in excess of purchases to purchases, and the growth rate of sales) in comparison to certain predetermined norms.
- About 15 per cent of audit cases may be selected

through a stratified random sample. This ensures presence of the tax department in the whole universe of taxpayers that imparts efficiency to the audit strategy.

It is important to constitute and parties having officials from different circles. Further, the officers responsible for conducting the audit should be different from the officer selecting cases for audit.

IDENTIFICATION OF TAX AVOIDANCE

Some of the taxpayers may take advantage of loopholes in the tax laws, that is, the circumstances that are not clearly defined or can bear different interpretations, for reducing their tax liability. The audit programmes can identify such tax avoidance. Once a particular form of avoidance is identified, the problem can be countered by making suitable amendments to the tax laws.

IDENTIFICATION OF UNREGISTERED POTENTIAL TAXPAYERS

Some of the persons who are required to register for VAT may not do so and avoid payment of VAT. Such persons may collect VAT in the form of higher profit margins in comparison to a registered person but are not required to pay the same to the exchequer. Some resources should be allocated for identifying such persons and bringing them into the tax net. Secondary sources of information such as location, area of business premises, type of activity, and telephone and electricity bills, may be explored for identifying unregistered potential taxpayers. Based on third party information, the officials may visit business premises of potential taxpayers for verifying the facts.

PENALTIES

Moderate penalties must be charged for non-compliance such as failure to register, issue correct invoices, file returns, and pay the tax. High penalties, which cannot actually be applied in most cases, will not be effective in checking non-compliance. If the probability of enforcing a penalty is low, the taxpayers will accept the risk, even if the penalty itself is sizeable. After all, taxpayers do travel by air knowing that they may have to pay the maximum penalty in case of an accident. They accept the risk because the probability of its occurrence is low.

Penalties could be applied in the form of: (I) fines, (ii) temporary shutdown of business premises, and (iii) imprisonment. The penalties in terms of fines and temporary shutdown of business premises are more likely to be applied than imprisonment, but imprisonment should be included in the law as the ultimate deterrent.

Penalties should be progressive for repeated defaults and there should be minimum discretion with the tax officials in applying penalties.

The penalty of temporary shutdown of business premises has been found successful in Bolivia, Chile, Philippines, and Taiwan. This type of penalty may be applied for persistant failure to comply with the tax laws.

Penalties, to be effective, should be applied expediously. Penalties that can be applied without resorting to courts will be more useful, such as, penal interest on late payment of tax, and automatic penalty on late filing of returns etc.

Penalties imposed should be made public as the purpose of penalties is not only to dissuade the identified violator to evade, but also to punish him as an example to others. It will be useful to give some publicity to defaulters by: sending the lists to other tax departments.

This strategy of publicity should be used at least in the cases of persistant failure to comply with the tax laws.

APPEALS

In case a dispute persists between the assessing official and the taxpayer, a three-tier system of appeals as recommended in the Model Statute for VAT prepared by NIPFP would be useful to minimise the number of appeals to the independent authority/ authorities. The first appeal should be made to a Departmental Appellate Authority, the second to the Appellate Tribunal, and the third to the High Court. A taxpayer should be required to pay the tax liability raised and penalties imposed by the tax officials before filing the appeal to the Appellate Tribunal or the High Court. This would avoid unnecessary appeals by the taxpayers to postpone payment of their tax liability. However, if the court decides the case in favour of the taxpayer, he should be paid an interest in addition to the excess payment made by him.

The tax department should have an appeals unit. Its prime responsibility should be to identify cases for appeal from the cases recommended by field audit on the basis of the merit of each case, and provide necessary support. Thus, all the cases recommended by field audit need not be taken up for prosecution. This will ensure high success rate of appeals, and thereby, high credibility of tax administration. Also, this will induce voluntary compliance. The strategy of selection of cases for appeal should be revised in the light of the experience gained.

TRANSPARENCY AND CREDIBILITY OF TAX ADMINISTRATION

Transparency and credibility of tax administration encourages voluntary compliance and imparts efficiency to tax administration. It is most effective when the tax administration is not only transparent and clean but is also seen to be so. The taxpayers should perceive the administration as a constant threat, so that, they do not engage in non-compliance. For achieving this, high morale and integrity of tax officials is a prerequisite. This can be facilitated by providing adequate working conditions and appropriate pay packages to the officials, accompanied by harsh penalties including imprisonment for corrupt tax officials. In this context, an effective vigilance department must be established.

COMPUTERISATION OF VAT ADMINISTRATION

Computerisation of VAT administration along with adequate administrative procedures imparts speed, efficiency, and productivity to the operations of tax administration, and hence boosts credibility of tax administration and encourages voluntary tax compliance. The computers permit an easy access to information processing, storage, and retrieval. These are used as means to encourage taxpayers to fulfil their tax obligations and for tax administrators to see that they do their work. The computerised tax administrations have proven to be very effective in the following ways:

- Creating a master file of taxpayers. A properly designed and operated master file of taxpayers is an essential element in many tax applications. A computerised taxpayer master file facilitates these tax applications.
- Performing typical manual tasks, but more quickly and accurately, including computing the correct tax from tax returns' data (and other sources); printing assessment notices, adjustment or error notices, payment demand notices, correspondence, refund checks, and summary reports.
- Performing new clerical functions, such as pre-addressing tax forms, identifying stopfilers, and delinquent taxpayers, and generating notices for them, maintaining a file of all taxpayers, and printing lists and analyses, as required.
- Matching or cross-checking internal and external sources to identify unregistered potential taxpayers (individuals and companies), as well as underreporting of sales and/or overstating of purchases, etc.
- Improving assistance and services to taxpayers by expeditious delivery of tax forms and refund checks and quick response to their inquiries.
- Assisting assessors, auditors, and investigators by relieving them of many clerical tasks, and providing them with "hot leads" concerning nonfilers and possible fraud cases. This leaves more time with the tax officials to attend to technical work and identification of the tax returns with the highest examination potential (for audit).
- Assisting collection officers in expeditious collection of arrears, by providing them with quick access to data about taxpayers' assets, sources of income, and other financial matters, as well as computerised phone contacts to delinquent taxpayers.
- Facilitating functional specialisation that increases effectiveness of tax administration. Generally, tax administrations are organised along functional lines reflecting four main functions (i) taxpayer information and registration, (ii) tax accounting and- data processing, (iii) tax collections (pursuing stopfilers and delinquent accounts), and (iv) audit (inspection and control)
- Providing revenue managers and executives with timely and accurate accounting, statistical and management reports, as well as quick access to other required data (the option to "pull" data, not regularly provided to them).

STAFFING AND TRAINING

For effective implementation of a VAT, it is important that taxpayers as well as officials understand the implications of VAT law. Further, modernisation of tax administration would require a change in the composition of staff. This would require reassignment of jobs and updating of skills of the existing officials, besides the addition of some technical staff particularly in the computer unit. Training of officials is a must and it should be tailor-made depending on the functions to be assigned to them. The auditors must have a good knowledge of accounting.

COST OF COMPLIANCE AND ADMINISTRATION

Cost of compliance (to taxpayers) as well as tax administration depends upon complexity of the tax structure and administrative procedures. It is a dead weight loss for the economy. The monetary as well as non-monetary cost of compliance and administration should be kept to the minimum possible by avoiding unnecessary complexities in the tax structure and complex and lengthy administrative procedures.

The design and administrative attributes that are helpful in checking cost of compliance and administration include the following:

- a single rate;
- low rate with a broad tax base;
- low threshold for registration;
- special treatment of small business enterprises;
- simple forms for registration and filing tax returns;

Chart 1

Model Application Form for VAT Registration

Form # VAT - 001

TIN (Tax Identification Number)	
01	

Name of the person to be registered

Single Proprietorships

02		03		04	
	Family Name		First Name		Middle Name

Corporations, Partnerships, Associates, etc.

05	

Style Name (if different)

06	

Address (No. Street, City, Pin, State)

07	

08	Telephone:	09	Fax:	10	E-mail:

Address of Branches (if any)

11	
12	
13	
14	
15	

Economic Activity

16	Code:	17	Description:

Sales of Taxable Goods and Services

Last Quarter	19	
Last Year	20	
Expected for the next 12 months	21	

Date of First Taxable Sale | 18 | D | M | Y |

I ______________ (proprietor/ director/secretary or other authorised person) hereby declare that the particulars given herein are correct and I hereby apply for registration for value-added tax.

Signature of Taxpayer
or authorised Officer

FOR OFFICIAL USE ONLY

Tax Office	22	

Date of registration | 23 | D | M | Y |

Registration refused | 24 | |

Received by:

A Model VAT Invoice

Chart 2

INVOICE – Page 1

Seller's Name ____________

Date ____________

Address ____________

Serial No. ____________

Taxpayer Identification No. ____________

ORIGINAL - BUYER

Telephone No. ____________

Buyer's Name ____________

Address ____________

Taxpayer Identification No. ____________

Telephone No. ____________

Terms of Sale ____________

(Rupees)

Quantity	Description of goods or services	Unit Price	Value	VAT 0%	VAT 5%	VAT 10%	Total
Q1							
Q2							
•							
Q3							
•							
•							
•							
•							
Total							

Printer's Name

Signature of taxpayer

34

Chart 2 (Contd.)

A Model VAT Invoice

INVOICE-Page 2

Serial No

Date

1st Copy - TAX CONTROL

This copy does not entitle holder to a tax credit

Seller's Name

Address

Telephone No.

Taxpayer Identification No.

Buyer's Name

Address

Taxpayer Identification No.

Telephone No.

Terms of Sale

Quantity	Description of goods or services	Unit Price	Value	VAT 0%	VAT 5%	VAT 10%	Total (Rupees)
01							
02							
03							
•							
•							
•							
•							
Total	[redacted]						

Printer's Name

Signature of taxpayer

Chart 2 (Contd.)
A Model VAT Invoice

INVOICE –Page 3

Seller's Name ______________________

Address ______________________

____

Telephone No. ______________________

Taxpayer Identification No. ______________________

Date ______________

Serial No. ______________

2^{nd} copy - SELLER

Buyer's Name ______________________

Address ______________________

____

Telephone No. ______________________

Taxpayer Identification No. ______________________

This copy does not entitle holder to a tax credit

Terms of Sale (Rupees)

Quantity	Description of goods or services	Unit Price	Value	VAT 0%	VAT 5%	VAT 10%	Total
Q1							
Q2							
Q3							
x							
x							
x							
x							
x							
Total							

Printer's Name

Signature of taxpayer

Chart 3
Working of VAT

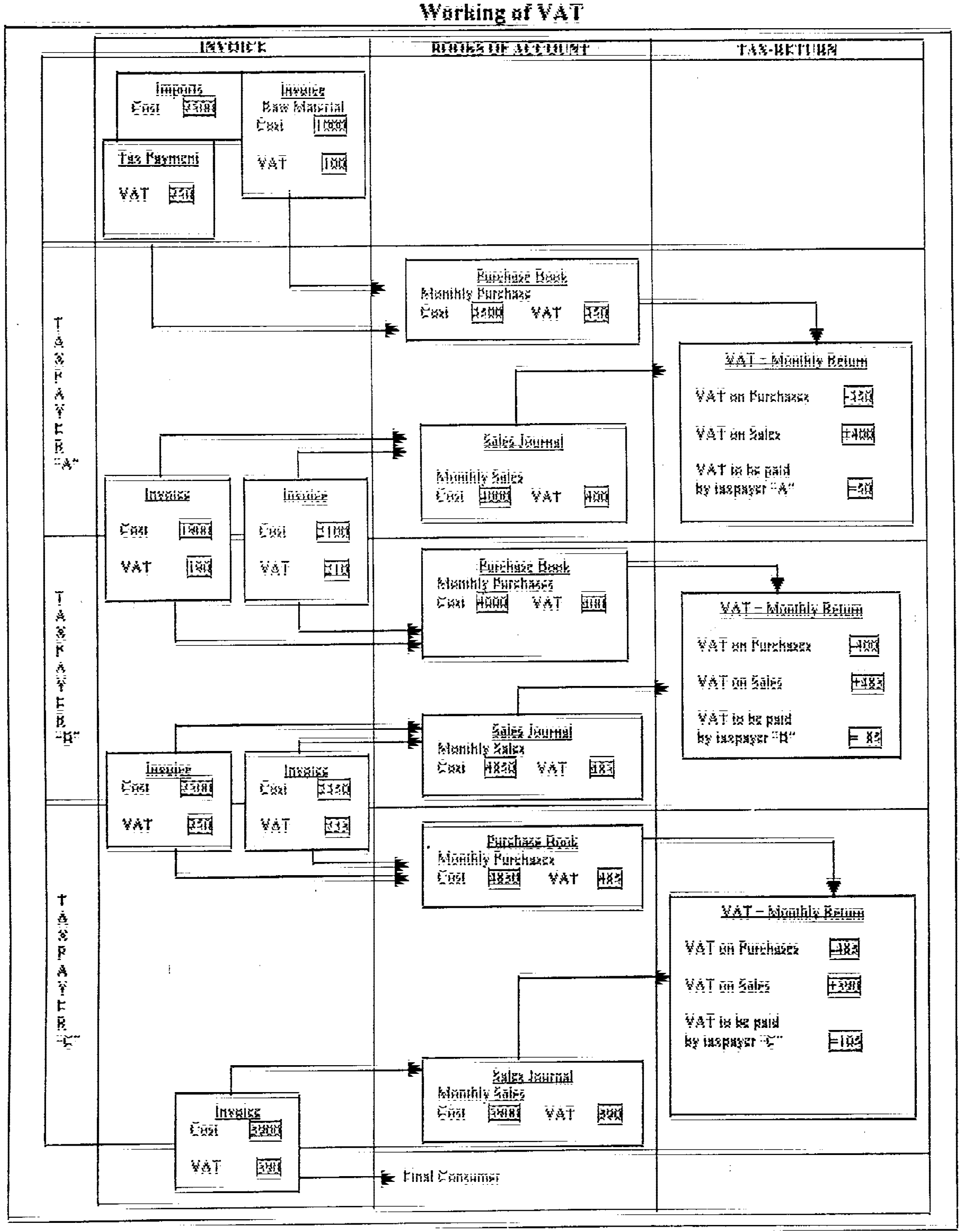


Chart 4

A Model Format for the Purchase Book

Taxpayer Identification Number ....

Purchases for period : Month .... Year ....

Invoice					Purchases (Rs)													
					Without VAT credit										With VAT credit			
					Exempted or non-credit category			4% VAT category			12.5% VAT category				4% VAT category		12.5% VAT category	
Date	Invoice No.	Seller's name	TIN	Total (including VAT) (Rs)	Imports	Inter-state purchases or inward transfers	Local purchases	Imports	Inter-state purchases or inward transfers	Local purchases	Imports	Inter-state purchases or inward transfers	Local purchases	Total without VAT credit (Rs)	Local purchases	VAT	Local purchases	VAT
1	22548572	A	33124512456	1200000	1000000	-	-	200000	-	-	400000	-	-	1200000	-	-	-	-
2	3421538	B	33623298642	1700000	-	300000	-	-	800000	-	-	700000	-	1700000	-	-	-	-
7	7115451	C	NA	3365000	-	-	-	-	-	200000	-	-	400000	1500000	1000000	50000	1000000	180000
15	3575188	D	33126542653	3241000	-	-	600000	-	-	-	-	-	2900000	3900000	800000	40000	700000	70000
25	570000	A	33124512456	1100000	-	-	-	400000	-	-	700000	-	-	1100000	-	-	-	-
Total				12596000	1000000	300000	600000	600000	800000	200000	1100000	700000	600000	6800000	1800000	90000	2700000	270000
References				F10	F14	F15	F16	F17	F18	F19	F20	F21	F22	F23	F24	F25	F26	F27

Notes :

1. It is assumed that inter-state purchases and inward transfers (consignment and branch transfers) are non-credit, and the imports are also not charged to VAT at the point of import.
2. NA: Not applicable.
3. F10 = F23 + F24 + F25 + F26 + F27
4. F23 = Total purchases not eligible for VAT credit.
   F25 = VAT paid on local purchases (4%)
   F27 = VAT paid on local purchases (12.5%)
5. Purchases: Monthly Accounting.

Transaction	Debit	Credit
Goods	F23 + F24 + F26	
VAT Input Credit	F25 + F27	
To Suppliers		F10

Chart 5
A Model Format for Sales Book

Taxpayer Identification Number ....

Sales for period: Month (....................) Year (...............)

Invoice				Total sales (including VAT) (Rs.)	Zero rated sales and transfers										Sales to local registered taxpayers (Rs.)					Sales to final consumers (Rs.)				
					Export of the category			Interstate sales of the category			Consignment or branch transfers			Total zero rated sales (Rs.)	Exempt	4%		12.5%		Exempt	4%		12.5%	
Date	Invoice No.	Buyer's name	TIN		Exemption	4% VAT	12.5% VAT	Exemption	4% VAT	12.5% VAT	Exemption	4% VAT	12.5% VAT		Base	Base	VAT	Base	VAT	Base	Base	VAT	Base	VAT
[illegible]	[illegible]	P	NA	[illegible]	[illegible]	[illegible]	[illegible]	–	–	–	–	–	–	[illegible]	–	–	–	–	–	–	–	–	–	–
[illegible]	[illegible]	Q	NA	[illegible]	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	R	[illegible]	[illegible]	–	–	–	–	–	–	–	–	–	–	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	–	–	–	–	–
[illegible]	[illegible]	S	[illegible]	[illegible]	–	–	–	[illegible]	[illegible]	[illegible]	–	–	–	[illegible]	–	–	–			–	–	–	–	–
[illegible]		Various	NA	[illegible]	[illegible]	[illegible]	[illegible]	–	–	–	–	–	–	[illegible]	–	–	–		–	–	[illegible]	[illegible]	[illegible]	[illegible]
Total				[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	–	–	–	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
References				[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Notes:

1. It is assumed that inter-state sales, and consignment and branch transfers are zero rated.
2. NA: Not applicable.
3. [illegible]
4. [illegible] = Total zero rated sales or transfers
   [illegible] = VAT charged to registered taxpayers (4%)
   [illegible] = VAT charged to registered taxpayers (12.5%)
   [illegible] = VAT charged to final consumers (4%)
   [illegible] = VAT charged to final consumers (12.5%)

Sales: Monthly Accounting

Transaction	Debit	Credit
Clients	[illegible]	
To Sales		[illegible]
VAT (Fiscal Debit)		[illegible]

Chart 6

A Model Monthly VAT Return and Payment Form

To be filed in triplicate in carbonless papers

Form # VAT – 002

Tax Period: Month | Year

[01]

Serial No. [00]

[02] Firm/Last Name

[03] First Name

[04] Middle Name

[05] Tax payer Identification Number (TIN)

[06] Address

[07] City

[08] Telephone

[09] Economic Activity Code

No Transactions During the Period

If no transaction during the period mark with an X ...... [10]

	To Deduct (Tax Credit)	Due (Tax Debit)
From Previous Month		
VAT credit from previous month	[11] +	
Refund Requested (Exporters Only)	[12] (-)	
Month's Purchases during the month		
Exempt or non-creditable purchases .... [P23]		
Purchases from domestic suppliers (5%)	[P25] +	
Purchases from domestic suppliers (10%)	[P27] +	
Month's Sales during the month		
Zero rated Sales .... [S39]		
Exempt sales .... [S39+S41]		
Sales to other VAT taxpayers (5%)		[S41] +
Sales to other VAT taxpayers (10%)		[S43] +
Sales to final consumers (5%)		[S46] +
Sales to final consumers (10%)		[S48] +
TOTALS	[P] =	[S] =

VAT Credit to be carried forward to following month [13]

If "P" (VAT-Purchases) is larger than "S" (VAT-Sales) enter difference here P-S

Total VAT due if paid on time [14]+

If "S" (VAT-Sales) is larger than "P" (VAT-Purchases) Enter Difference here

Interest for late payments [15]+

Penalties:

Fine for late payment [16]+

Fine for late filing [17]+

Total amount payable [18] =

Total Paid [19]

Balance Payable [18]-[19]=

I declare under oath that the information provided in this document is true and correct.

Signature of taxpayer or authorised person

Notes:

1. [P] = [11] – [12] + [P25] + [P27]; [S] = [S41] + [S43] + [S46] + [S48]
2. [18] = [14] + [15] + [16] + [17]

Chapter - 9

VAT Frauds / Leakages

The genuine dealers those registered under VAT may be drawn into the edding of innocent plans designed by organised cheaters. the dealers must aware of the possible areas where such fraud can be designed and implemented by the cheaters. It is important for the dealers to be vigilant and do not unknowingly become party to an organised fraud as in the case of a "Missing Trade Fraud" or "Cloning Fraud".

1. Suppression of Output:

This is a deliberate act of the VAT registered dealer to record all his sales. This is more prevalent in those traders where cash payment is common.

2. Under valuation of Output:

Under valuation is the most infamous way of evasion. Here the unit declares a lower price than the actual price. This may again be done in two ways. Usually the taxpayer gets into understanding with the receiver of goods and a lower price is declared in the documents. The tax payer may decide to totally ignore his counterpart if he is daring enough to forge documents and replace the genuine ones.

3. Misdeclaration of Quantity

Misdeclaration of quantity is resorted to whenever there is little scope of under valuation and where counting or measurement of quantity is a prohibitively problematic task. The advantage is that (i) there is little scope of detection from documentary audit or scrutiny and so, (ii) once the consignment is cleared out there is virtually no way to establish that an evasion had been effected. Misdeclaration of quantity is a favourite form of evasion. Miscalculation may also take place. Straight forward error of calculation either in calculating the assessable value or the tax liability may be restored to by the tax payer. Another way to evade tax liability may through forging of payment receipts for clearance. Frauds under 1 to 3 above can be checked by framing proper rules regulating the Input Tax Credit that can be carried forward from one accounting year to the next. Under the draft VAT law of various States the dealer is allowed to carry forward the unavailed input tax credit in one tax period to the next. By suppression of Output tax payable by under invoicing, the input tax remaining unadjusted will remain inflated. At the end of the year the dealer will have an inflated input tax credit disproportionate to the input tax actually paid on the goods remaining in stock. The dealer may be required to file a yearly declaration of stock with details of input tax paid thereon and the input tax credit eligible for carry over to the next year may be restricted to the input tax actually paid on goods in stock.

4. Inflation of Input Tax Credit:

This is the device by which the dealer inflates the input tax credit through the use of false Invoice to show non-existent or overvalued purchases.

Though filing of a stock declaration at the end of the year may partly check this type of fraud, the use of false invoice can be checked as discussed under "Missing Trader Fraud".

5. Export VAT Fraud or Export Diversion fraud:

The dealer applies zero rate for non existent or overvalued exports, and claims refund but diverts the covered goods to home use, Basic consumer, .and luxury goods have been involved In such frauds.

This fraud can be checked only on an inspection of the documents filed in proof of exports.

6. Carousel fraud:

Essentially this fraud involves abuse of the exemption mechanism of the VAT system. It Is reported that during the first half of 1998 EU Member States detected around 250 cases of such fraud (called carousel or IC- acquisition fraud) involving a revenue loss of around €500 million (an average of about €2 million per case). A point of particular concern is that, according to the tax administrations of EU) Member States, the amount of tax defrauded in individual cases is growing.

Carousel fraud is the carrying out of repeated (cross border) purchase and sales transactions within a rapidly changing group of companies.-The cross-border dimension means that VAT is not paid in the country of origin but the company In the country of destination disappears without payment of VAT, Usually an extensive and complicated chain of transactions in several countries is used to cover up what is actually happening. Carousel fraud is often perpetrated by criminal organisations and involves considerable losses to exchequers.

Carousel fraud involves the continuous movement of goods between co-operating traders In different EU member states, resulting In multiple tax losses.

The fraudsters often insert a series of companies into the supply chain to make detection difficult. Goods that are easily traded and have a high value and low transport costs, such as computer components and, mobile phones, are particularly attractive to Missing Trader fraudsters. The goods themselves may remain in one place, but financial transactions give the appearance of numerous business purchases and sales.

Relevance in Indian Context

India does not face the immediate prospect of facing Carousel fraud which happens due to the system of charging the VAT on Inter EU sale between different countries. Under the system in vogue, in the case of trade between two VAT registered dealers in different countries, the sale is zero rated in the exporting State and the VAT tax is paid by the importing dealer at the point of purchase. Input Tax Credit can be availed of the VAT paid on the Imported goods when the goods are subsequently sold. In the case of export by a VAT registered dealer to a non-registered dealer, the exporting dealer bills the VAT.

In India, there is a strong lobby, which calls for making Inter State Sale Zero-rated. If that happens without a proper mechanism to track and monitor Inter State sale we may have to face similar frauds.

7. Missing Trader Infra Community fraud (MTIC) or Acquisition fraud:

The dealer registers under the VAT, charges the VAT on his sale but disappears without sending any return or paying the VAT due.

Missing Trader Intra Community fraud (MTIC) exploits weaknesses in the intra EU VAT system and is prevalent in all EU member states. It appears to have started to escalate in the UK around 1998. The fraud involves obtaining VAT registration for the purpose of purchasing goods from a VAT- free source elsewhere in the EU, selling the goods at a VAT-inclusive purchase price, and going missing without paying the VAT. This is commonly known as acquisition fraud, and often involves items with rapid turnovers that are moved in high volumes, such as soft drinks and confectionery.

8. Cloning Fraud

This is a fraud perpetuated by using the VAT Registration numbers of reputable companies. The modus operand is that a person carries on business without registering himself but by using the VAT registration number of someone else. The dealer disappears without filing VAT returns as he obviously cannot file using the hijacked VAT registration number. The innocent buyer of goods from this dealer who claims Input Tax Credit on the purchases effected faces the prospect of his claim being disallowed at a later date when the officials discover that the invoice is bogus. The dealer whose number has been hijacked also has to face the demand for payment; of the VAT on the bogus invoices raised in his name and has to convince the officials that he had not issued those Invoices.

Relevance in Indian Context

The case of Missing Trader or Cloning also happens in a single point system of levy. Tax administrators in India will be familiar with “Bill Trading” whereby exemption is claimed as second sales based on an invoice with non-existent or bogus RC number.

The VAT information system should have a proper mechanism to monitor new registrations particularly with greater attention to the following:

1. By experience the officials will know the problem areas and commodities. ‘New registration for business in the designated areas and in the designated commodities must be flagged as “Risk activity” for monitoring even at the time of registration.

2. Fraudulent persons will immediately come to know of the commodities being monitored and will avoid registering as dealers in the commodities being monitored. The tendency will therefore to register as dealers in some other commodity. The VAT information system should alert when the, commodity reported in the monthly returns' are different from the commodities declared at the time of registration.

3. The system should also cross check the commodities on which Input tax credit Is claimed by all dealers with the corresponding return of the selling dealers for the commodities sold.

4. The software must also provide for cross checking of output tax declared by dealers with the Input tax credit claimed by other dealers as purchases from a particular dealer.

5. The software should have a proper alert mechanism in the VAT Information system to track stop filers, new registrants declaring abnormally high sales In the initial months of registration.

6. From experience the officials will know that a particular type of fraud perpetuated is generally confined to a local area or a particular commodity. It may be noticed from experience that a fraud like, say, "Bill-Trading" Is replicated In a particular locality by more traders when they see another dealer successfully operating a "Bill Trading" network. Applications for new registration from particular areas or for particular commodities that have been Identified should be carefully scrutinised.

7. The system should facilitate access to the dealers to verify their tax, credit status and the proper recording of their returns, if not filed online by the dealers. The dealers should also have access to the list of dealers who have claimed Input tax credit based on sales of the dealer so that "cloning" fraud may be detected by the dealer himself.

8. The software should be designed to analyse trends in tax credit it and output, tax declared commodity wise and should automatically alert in the case of a abnormal rise or fall in the tax credit availed/ output tax payments in any specific commodity.

The department must take enough care in registering a dealer under VAT rather than penalising a genuine dealer at a later date.

Trade and Industry should carefully study the penal provisions in the draft VAT Act to ensure that there are no provisions penalising a genuine dealer for the inability or the delay on the part of the department in tracing a fraudster.

9. Repayment Fraud:

This Is a device whereby someone registers a totally false VAT business with the aim of submitting false repayment returns.

Repayment fraud comprises the recovery of VAT on wholly fictitious or exaggerated transactions by a bogus business.

10. Muiti cell repayment fraud:

This Is a sophisticated version of the repayment fraud where someone sets up multiple bogus registration, each of which reclaims small amounts of VAT.

Repayment frauds can be detected only on personal inspection of newly registered businesses and periodical survey.

11. Misdescription of the VAT liability:

This occurs when supplies are recorded as zero-rated or subject to tax at a rate lower than that applicable to the relevant goods. This can be detected by scrutiny of the returns filed. Wrong application of rate of tax may be also a genuine mistake on the part of the dealer. In the absence of a scrutiny of returns filed for every tax period, wrong application of rate of tax will be detected only at the time of final assessment and this will affect all dealers upstream and downstream in the supply chain. To have, accountability on the part of the officials and to safeguard a genuine mistake in the application of the rate of tax, there should be a provision in the VAT Acts that no demand can be raised beyond six months from the date of filling of returns.

12. Contrived Insolvency and Fraudulent Liquidation:

Under this huge VAT liability is built up and the business is fraudulently liquidated.

Only seasoned and organised fraudsters will attempt this type of fraud. Stop filers need to be closely monitored to detect the fraud early.

13. Unreglstered evader fraud:

This involves genuine traders who have turnovers above the VAT threshold but fail to register for VAT. These categories of tax evasion are usually concentrated in cash-based businesses.

Types Of Vat Avoidance Schemes

The different types of VAT avoidance schemes encountered internationally may be categorised as follows:

1. Disintegration:

This involves artificial fragmentation of business into smaller units to keep the turnover below the threshold limit and avoid registration under the VAT. This may happen in India probably only in the case of retail traders.

2. Partial Exemption:

Partial input tax credit is required to be calculated when tax paid Inputs are either used in the manufacture partly of tax paid goods and partly exempt goods or when the goods purchased are sold partly to taxable entities and partly to exempt entities.

By exploiting the rules which apply to partly exempt Supplies, traders recover substantially more tax than was intended.

This can be plugged by providing for practical rules of apportionment of Input tax credit between taxable and exempt sales.

The VAT strategy

Summary of the VAT strategy

The key measures, which will deliver the VAT strategy, are as follows:

1. The deployment of 1,000 staff both to enhance existing efforts in the key problem areas and provide the resources for the new activities described below;

2. A new out-reach programme designed to get businesses, especially newly-registered ones, into a sustained pattern of voluntary compliance;

3. A broader-based. Intelligence-led, risk-based approach to tackling non-compliance, based on improved analysis of the patterns of non-compliance, and targeting of resources on high-risk sectors of the economy;

4. An Increase In the use of deposits and guarantees to secure timely VAT payments from businesses with histories of persistent non-compliance;

5. A one-off, short-term scheme where unregistered businesses operating above the VAT threshold will be able to obtain relief on their penalties If they come forward for registration voluntarily;

6. Followed by a tough crackdown - alongside Inland Revenue - on those businesses who continue operating above the registration threshold but outside the VAT system; The recruitment of a number of new highly-specialised anti-avoidance experts with proven ability to identify and shut down legislative loopholes and abusive tax avoidance schemes;

7. The Inclusion - alongside the Regulatory Impact Assessments which accompany new legislation - of a specific avoidance Impact assessment, explaining the elements Included to prevent avoidance and the steps taken to make the legislation avoidance-proof; A substantial increase both In the speed with which avoidance schemes are Identified, and In the number of schemes challenged;

8. A stepping up of efforts to prevent bogus traders from registering. Identify those already on the register, stop their frauds before they grow, and recover VAT Missing Trader debts from the fraudsters; and

9. The use of Customs' specialist investigators, with proven track records In dismantling organised criminal operations, to target the gangs behind Missing Trader Fraud.

The purpose of this article is not to cause alarm but to draw attention to International experience in tackling VAT leakage find evasion.

Chapter - 10

Question and Answer on VAT

1. What is VAT?

VAT is the short form of Value Added Tax. VAT, in simple terms, is a multi point levy on each of the entities in the supply chain with the facility of set off of Input Tax i.e., the tax paid at the stage of purchase of goods by a trader and on purchase of raw materials by a manufacturer, i.e., only the Value addition in the hands of each of the entities is subject to tax. The levy of VAT will be administered by the Value Added Tax Act and the rules made there under.

2. What will happen to the present sales tax Act?

The present Sales Tax Act will be repealed. Only the pending proceedings and assessments upto 31/03/2003 will be governed by the present sales tax Acts.

Certain goods like Lottery Tickets, Petroleum products etc., may not be taxed under the VAT Act. Some State Governments may decide to make the present sales tax Act applicable to such goods.

***3.* Will there be a single VAT Act for the whole country like the Central Sales Tax Act?**

No. Each State will enact a separate VAT Act that will replace the present Sales Tax Act.

4. Is VAT the same as the Multi point levy of sale tax under the present system of levy of sales Tax? If not. How is it different?

Under the present sales tax law, multi point levy means charging of tax on every point of sale on the respective sale price. The tax paid on purchase was not eligible to be deducted from the tax paid on the sale price.

Under VAT, though tax is levied on every dealer in the supply chain, the dealer will charge tax on the sale value and collect from the buyer. However while remitting the tax to the Government, the tax paid on the purchases will be deducted and only the net tax remitted. So what is effectively subject to tax is the value addition in the hands of the dealer.

For instance, if a dealer purchases goods for Rs.100/- from a dealer and tax of Rs.10/- has been charged in the bill and sells the goods for Rs.120/- on which the dealer will charge tax of Rs.12/- at 10%, the tax payable by the dealer will be only Rs.2/- being the difference between the tax collected of Rs.12/- and tax already paid on purchases of Rs10/-.

Thus the dealer has paid tax at 10% on Rs.20/- being the value addition in his hands.

Purchase Price	Rs.100/-
Tax paid on purchase	Rs.10/- (input tax)
Sale Price	Rs.120/-
Tax payable on sale price	Rs.12/- (output tax)
Input tax credit	Rs.10/-
VAT payable	Rs.2/-

5. What are the advantages of VAT?

The perceived advantages are

- **GENERAL**

* It is simple
* Shares the burden to all levels of supply chain
* Taxes only the value addition
* Fewer rates
* Uniform floor rate throughout the country
* Uniform classification of goods throughout the country
* Will not cascade
* Lesser procedure
* Helps better compliance and audit trail
* Larger tax base

- **TO MANUFACTURERS**

* No input tax burden on inventories
* Exports become competitive
* Domestic products have no hidden taxes

6. What Is Input Tax?

"Input" normally means goods purchased by a dealer in the course of his business. The purchases would include any goods purchased by a dealer in the course of his business for re-sale or for use in the manufacture or processing or packing or storing of other goods or any other use in business.

Input Tax is the tax paid on inputs. Input tax has been defined in section 2 (25) of the Tamil Nadu VAT Act, 2003 as "Input Tax means tax paid or payable under this Act by any registered dealer on purchase of any goods for manufacture or re-sale".

7. What Is Input Tax Credit?

Input tax credit Is the credit for tax paid on inputs. Every dealer is liable for output tax on the taxable sale effected by him. The basic principle of VAT is that every dealer pays tax only on the value addition in his hands. Input tax credit is the mechanism by which the dealer is enabled to setoff against his output tax, the input tax.

8. Will input tax credit be available on all purchases for the business?

Generally, input tax credit will be eligible on all goods purchased for resale/raw materials and packing materials for use in the manufacture of goods. Eligibility of input tax credit on capital goods is discussed separately.

Only goods purchased from VAT registered dealers' in the State will be eligible for input tax credit. Input tax credit will not be available on Inter State purchases, unless otherwise provided in the State VAT Act.

There are likely to be restrictions or denial of Input tax credit on Petroleum products, Tobacco and certain other products. One should 'refer to; their respective State VAT Acts. Goods ineligible for Input Tax credit are also referred to as "Input Tax Credit Blocked goods".

In the leaflet published by the Andhra Pradesh Commercial Taxes Department an illustrative list of purchases on which input tax credit is not eligible is listed.

9. How is input tax credit to be claimed? Is there any requirement of a "one to one" correlation between Input tax and output tax?

There Is no need for a "one to one" correlation between input tax credit and output tax. Quite a large number of small businesses are under the misconception that input tax has to be adjusted against output tax on a bill to bill basis and have been opposing the implementation of VAT stating that their profit margin would be known to the buyer and that account keeping would "be impossible.

The operation of the input tax mechanism is very simple. The dealer will be eligible to take credit of eligible input tax in a month (or such tax period as may be specified) on the entire purchases. The dealer would charge 'VAT at the prescribed rate of tax as is being done in the present system of levy of sales tax. The VAT or Output Tax payable is compiled on a monthly basis as is done now. The dealer can adjust the input tax eligible on the entire purchase-In the tax period against the output tax payable irrespective whether the entire, goods purchased is sold or not.

For example, if the input tax credit in a particular month is Rs.10,000/- the output tax payable is Rs.5,000/-, the excess input tax of Rs.5,000/- can be carried forward to the next tax period. Assuming no further input tax credit In the following month and that the output tax payable is Rs.7,000/-, the dealer will pay Rs.2000/-along with the monthly return.

10. Is there any restriction of availing of input tax on depending on the manner of disposal of goods say as free gifts or on stock transfer?

Yes. Input tax credit will be available on output tax payable on sales within the State.

Restricted input tax credit is likely to be available on stock transfers/consignment despatches to outside the State as discussed separately.

11. WIll input tax credit be available on Inter State Purchases?

Input tax credit will not be available on Inter State purchases for the obvious reason that your State cannot be expected to give credit for the tax paid in the State of the selling dealer. The denial of input tax credit on inter state purchase may violate the Constitution.

Since denial of input tax credit on inter state purchase may lead to cascading of taxes, the possibility of allowing input tax credit on inter state purchase of raw materials may be considered with a suitable mechanism to compensate revenue loss to the States.

To avoid cascading of taxes on denial of input tax credit on Inter State purchases, the empowered committee of State Finance Ministers have decided to reduce the CST to 2% from and 2004-05 and to 0% thereafter.

Most of the States have specifically provided that input tax credit will be available ,, only on purchases from VAT registered dealers within the State and that no input tax Credit will be available for inter State purchases.

However, Section 16 of the Pondicherry VAT draft Act provides, for input tax credit of the CST paid as under:

Tax Payable

(i) Input Tax Credit (ITC) - For the purpose of calculating the net tax (VAT) payable by a dealer for each tax period, an input tax credit shall be allowed against the output tax;

Provided that -

(ii) for purchase of goods in the course of inter-State trade or commerce, the input tax credit shall be restricted to four percent of the input value or the actual tax paid, whichever is less.

12. Will input tax credit be available for the entire tax paid on eligible purchases?

Input tax credit will be available on the entire VAT paid on purchases. However certain States are contemplating the levy of non Vattable "Special Additional Tax" (SAT) which will not be eligible for Input tax credit. It is expected that SAT may be levied only at the first point of sale on a select list of commodities. Goods subject to SAT will be known when the Schedules are published by the respective States.

13. What proof is required to claim input tax credit?

Input tax credit can be claimed only on purchases from VAT Registered Dealers. The Original Invoices is the proof required to claim Input Tax Credit. The invoices must be preserved carefully to be produced in assessment proceedings.

There may be circumstances when the original invoice is lost or destroyed. The VAT Rules of the respective States will provide for the procedure to be followed in such contingencies.

14. Input tax credit can be taken only on the basis of a tax Invoice Issued by a VAT registered dealer. How can the buying dealer verify If the selling dealer has genuinely registered or not? Should the Input tax credit already taken be reversed if at a later date it is found that the selling dealer's VAT registration had been cancelled or suspended?

The onus of proof shall be on the dealer to establish that the dealer is eligible, for input tax credit availed. It is expected that the respective States may make available on their web site the details of registered dealers details of registrations cancelled or suspended.

If the selling dealer is not a genuine dealer holding a valid registration certificate, the buying dealer may have to reverse the input tax credit already taken. Section 17(8) (viii) of the Model VAT Bill specifically provides that input tax credit shall not be available in respect of goods purchased from a dealer whose certificate of registration has been suspended. Please refer to the section on "Input Tax Credit" In the respective State VAT Act for a similar provision.

Please also refer to the article in this book on "Insulating your business from VAT frauds"

15. Can input tax credit be claimed on stock of goods on the date of implementation of VAT?

Since stock of Goods as on 31/03/2003 will be liable to VAT on sale from 01/04/2003, the tax paid under the present Sales tax will be eligible for Input Tax credit subject to conditions and restrictions as may be stipulated in the respective State VAT Acts.

16. Are all dealers eligible to claim input tax credit?

All VAT registered dealers can claim Input Tax Credit on the eligible purchases. However retail dealers paying Presumptive Tax will not be eligible for Input tax.

17. What is the procedure for adjusting input tax paid against the output tax payable?

In the return filed for the Tax Period there will be a column for input tax credit, which will have to be filled in. Copies of the invoices in support of the claim of Input tax credit will have to be preserved.

18. What Is the meaning of "Reverse Credit" of input tax?

As-discussed in the reply to other questions, there are restrictions on the eligibility .of input tax credit depending upon the use of goods on which input tax credit has been availed and depending upon the manner of disposal of the goods on,:which Input tax credit has been availed.

For- Instance, where goods on which input tax credit has been taken is later on used in the manufacture of taxable and exempt goods, the input tax credit availed on goods used In the manufacture of exempt goods shall be reversed.

There will be a specific column in the monthly returns for deduction of "Reverse Credit against the Input tax credit carried forward from an earlier period.

The rules will provide for the manner of calculating the "Reverse Credit" of input Tax.

19. What is the procedure, in the case of a dealer, to adjust the input tax ''against output tax when the dealer makes taxable and exempt supplies? Will the Input tax credit relating to exempt supplies lapse?

Input Tax Credit shall normally be available on goods purchased for

a. sale or resale in the State; or

b. use as raw material or as capital goods in the manufacturing and processing of goods other than those exempt from tax under this Act intended for sale in the State ; or

c. sale In the course of export out of the territory of India; or

d. for use as containers for packing of goods other than those exempt from tax under this Act for sale or resale in the State.

The sale so effected (except in the course of export) shall normally be subject to, tax. There are certain exempt transaction as may be specified in the respective State VAT Acts on which VAT is not chargeable.

If the purchases are used partially for the purposes specified, input tax credit shall be allowed proportionate to the extent they re used for the purposes specified above.

The VAT Rules of the; respective States will provide for the manner of apportionment. Input tax credit may be claimed proportionate to the extent the inputs have been used towards taxable sale.

What happens to the input tax credit on the portion of purchases relating to exempt transactions?

There shall be a "Reverse Credit" of the input tax credit reliable to the exempt transactions, i.e., the proportionate input tax credit shall be deducted from the Input Tax Credit taken.

Sub section 9 of section 17 of the Model VAT Bill which provides for reverse credit of input tax reads as under:

17 (9) If goods purchased are intended for use specified under sub-section (4) (listed as (a) to (d) above)or loss of goods arising out of theft or destruction for any reason or the Stock of goods remaining unsold at the time of closure of business and are subsequently used, fully or partly, for purposes other than those specified under the said sub-

section, the input tax credit availed at the time of such purchase shall be reduced from the tax credit for the period during which the said utilisation has taken place:

Provided that if part of the goods purchased are utilised otherwise, the amount of reverse tax credit shall be proportionately calculated in a manner that is just and reasonable.

20. In the case of a manufacturer who manufactures partly exempt goods and partly taxable goods, what is the eligibility of input tax credit? Will the input tax credit relating to manufacture of exempt goods lapse?

The answer to the previous question relating to traders shall apply.

21. Can a dealer whose input tax credit exceeds the output tax payable In tax period or in a year claim refund of the excess credit of Input tax?

Since the rate of tax on input and sales is the same in the case of a dealer, there will only be value addition and there may not be a situation where the input tax credit exceeds the output tax payable.

However in the case of a manufacturer it may happen that the rate of tax on raw materials and packing materials is higher than the tax on the output and there may be a Input tax/output tax mismatch in spite of the value addition and the manufacturer may carry forward a substantial unadjusted Input Tax Credit.

Section 18 of the Model VAT Bill provides as follows:

18. Input tax credit exceeding tax liability;-

(1) If the input tax credit of a registered dealer other than an exporter selling goods outside the territory of India determined under section 17 of this Act for a period exceeds the tax liability for that period, the excess credit shall be set off against any outstanding tax, penalty or interest under this Act.

(2) The excess input tax credit after adjustment under sub-section (1) may be carried over as an input tax credit to the subsequent period or periods.

(3) In case where input tax credit is carried forward, a quarterly credit statement may be forwarded to the dealer concerned and the claims reconciled accordingly.

No refund is provided of the excess Input Tax Credit carried forward.

However In the Andhra Pradesh draft VAT Act refund is provided in certain circumstances as provided in Section 38(l)(b) reproduced below:

"S.38(l)(b) In all other cases the VAT dealer shall make application for refund of an excess credit where such dealer has declared an excess credit for 24 consecutive months or more or his registration is to be cancelled. In such cases the' Commissioner or any prescribed authority shall refund him the excess credit on that return within three months of the due date for the return for the tax period to which the excess relates, or within three months of the date when the return was filed if the return was not filed by the due date."

Refund of excess Input Tax Credit is also provided in the Assam Draft VAT Act In S. 50(2).

S.50 (2) Where the amount of Input tax credit admissible to a ' registered dealer for a given period exceeds the tax payable by him for the period, he may, subject to such restrictions and conditions as may be prescribed, seek refund of the excess amount, by making an application in the prescribed form and manner, containing the prescribed particulars and accompanied with the prescribed documents to the prescribed authority, or adjust the same provisionally with his future liability to tax in the manner prescribed:

Provided that, the amount of tax or penalty, interest or sum forfeited or all of them due from, and payable by the dealer on the date of such adjustment shall first be deducted from such refund before adjustment".

The respective State draft Act may be referred to for refund provisions applicable.

22. What are the circumstances in which refund of input tax credit is permissible?

Refund of Input Tax Credit Is normally permissible in the case of a Zero Rated Sale. Zero Rated sales are specified in the respective State VAT Acts. At present, only Exports out of the country is likely to be a zero rated sale. The input tax credit,relatable to the export sales will be eligible for refund.

Refund may also arise In the case of Input Tax credit exceeding tax liability. The eligibility in such cases is separately discussed.

23. Is input tax credit available on Inter State sale of goods?

The Input Tax credit available shall first be adjusted against the Output tax payable on the sale of goods. If excess credit is available the dealer may at his option adjust the credit against the CST payable and the balance input tax credit available can be carried forward to the next tax period.

In the Kerala VAT draft the adjustment of Input Tax Credit against CST payable is not permitted. The dealer is required to claim refund of the input tax credit on inter state sale at a rate not exceeding 4%.

Please refer to the section on "Net Tax Payable" or "Output Tax payable" in the respective State VAT draft Act.

24. Should Input tax credit availed be reversed if the inter State sale is exempt?

Yes. Input tax credit is eligible only when output tax payable (except for zero rated sales). If the inter State sale is exempt, the corresponding input tax credit should be reversed.

25. Is input tax credit available on goods stock transferred? If ineligible will the input tax credit relating to the goods stock transferred lapse?

There had been lot of discussion on the availability of Input Tax Credit on goods stock transferred. Since goods stock transferred are not subject to tax the States were reluctant to give input tax credit. The consensus now Is that the States shall give input tax credit of tax paid on purchases in excess of 4%. By blocking of input tax credit of 4%, the goods stock transferred are indirectly taxed at 4% of the purchase value.

In the case of raw materials used in the manufacture of goods that are despatched on stock transfer, input tax credit on raw materials shall be eligible for tax paid in excess of 4%.

Though the draft VAT Acts of certain States provide for no input tax credit on goods despatched on stock transfer, it is expected that the provision for set off will be incorporated in the final VAT Act.

Section 17(8) of the Model VAT bill provides as follows:

17(8) No input tax credit under sub-section (1) shall be claimed or be allowed to a registered dealer-

ix. in respect of goods used for transfer of stock other than by way of sale outside the State of ___________:

xi. in respect of raw materials used in manufacture or processing of goods where the finished products are dispatched other than by way of sales :

Provided that in respect of transactions falling under item (ix). Input tax credit may be allowed on the tax paid in excess of 4% on the raw materials used directly in the manufacture of the finished products.

The manner of computation of the disallowance is not clear. There are likely to problems in computation of disallowance when a number of raw materials are used for the manufacture of a single product. The rules need to be properly, framed for computation of the input tax credit eligible.

The 4% input tax credit if already taken will lapse and will have to be reversed.

26. What are the provision relating to input tax credit on free samples and gifts?

In respect of goods distributed as free samples or gifts the input tax credit on the goods if already availed will have to be reversed. The reason is that input tax credit is eligible only on taxable sale. In the case of free gifts and samples, there is no sale and consequently no output tax is payable.

27. How is input tax, credit to be adjusted when the goods have been lost by theft?

In case of loss of goods by theft the input tax credit on the goods if already availed will have to be reversed.

28. How is Input Tax Credit to be adjusted when the selling dealer issues a debit note towards additional charges or when a credit note is issued by the selling dealer towards rebate or goods returned?

When a dealer bills for additional charges with reference to a sale already effected, the dealer should issue a debit note charging VAT on the differential sale price. The purchasing dealer shall be eligible to take credit of the VAT charged in the debit note.

In the case of goods returned, the dealer who has purchased the goods will issue a debit note charging VAT on the value of the goods returned and the selling dealer can take credit of the VAT charged in the debit note.

It will be a sound accounting practice to issue a debit note for the credit note received and vice versa and account based on the debit note or credit note, as the case may be, issued by the respective dealer.

29. How is input tax credit to be adjusted when the goods are partly used for business purposes and partly for non business purposes. For instance, if the goods are given for the personal use of the proprietor, partners or employees of the business?

In the case of goods used/disposed off for other than by way of sale the corresponding Input tax credit shall be reversed in the month in which the goods are used otherwise.

30. What is the eligibility of Input Tax credit on Packing Materials?

Packing materials will be eligible for input tax credit when sold as such or used for packing of goods for taxable sale.

It is to be noted that input tax credit on packing materials used to pack exempt goods may have to be reversed since no output tax is paid on the exempt goods.

31. In the case of a dealer with more than one place of business in the State, under the present sales tax Act, one of the places of business is designated as the principal place of business and the return is filed consolidating the turnover of all the places of business in the State. Will the same procedure continue under VAT and can the Input tax credit of one place of business adjusted against the output tax payable in respect of another place of business in the return filed?

The present procedure of a single registration in the State for each dealer will continue in VAT. However, as at present, the dealer will have to declare details of the other places of business, godowns, etc., in the State and obtain an appropriate Branch or Godown registration certificate as at present. The procedures will be specified in the VAT Rules.

Since a consolidated return is to be filed for the Principal place of business consolidating the sales in all the places of business, the input tax credit will also be claimed for the business as a whole, unless otherwise provided in the VAT Act of the respective State.

32. What is Output Tax?

Output Tax is the tax payable by a dealer in respect of any taxable sale made in the course of business and includes tax payable by a commission agent for taxable sales made within the State on behalf of a principal.

Output Tax is nothing but the tax payable on the sales. The dealer will charge the applicable rate of VAT for the goods sold.

33. Is output tax payable on free supplies on a notional value?

The transaction must qualify as a sale to be liable to output lax. What is a sale is discussed in the chapter on "Sale".

Since no consideration is received on free supplies output tax is not payable. However the Input tax credit if already taken on free supplies will be reversed.

34. How is Output Tax due for a tax period to be computed?

Output tax is to be computed the same way the sales turnover is computed for the monthly sales tax returns as at present. The tax charged in all the invoices are totaled and adjusted for sales return, cancelled invoices, mistakes in application of rate or invoice value, etc.

35. How is the net tax to be paid in the monthly returns to be calculated by a registered dealer? If the net payable in a month is in the negative, What are the provisions relating to adjustment against any other tax liability and how is the negative output tax to be adjusted?

The net tax payable by a registered dealer for a tax period shall be the difference between the output tax and the input tax, plus purchase tax if any, which can be determined from the following formula.

Net tax payable = Output Tax - (Purchase Tax paid by the dealer + Input tax Credit eligible for the tax period)

The purchase tax to be eligible for set off should have been paid for goods used for manufacture/sale of taxable goods.

The provisions relating to input tax eligible for adjustment against the output tax payable is discussed in the chapter on "Input Tax Credit"

For example, if the Output Tax Payable is Rs.10,000/-, the purchase tax paid is Rs.1,000/- and the Input Tax credit eligible is Rs.5000/- , the net tax payable by the dealer is Rs.4,000/- for the tax period.

If in the above example, the output tax payable is only Rs.5000/-, the dealer will be eligible to carry forward to the next tax period Rs.1,000/- being the Input tax credit not adjusted In the current tax period for adjustment against the net tax payable for the next tax period or the next year if the credit continues till the last month of the year.

The credit of Rs.1,000/- may also be applied towards the CST payable by the dealer.

36. If the Output Tax continues to be negative for a continuous period due to input tax exceeding output tax payable. Will the excess output tax be refunded?

This situation may not happen in the case of a trader as there can be only value addition and the output tax payable will exceed the input tax credit.

In the case of a manufacturer there is a possibility that there may be excess input tax credit when the raw materials and the finished goods are taxable at different rates and the value addition is not very material.

Logically the excess input tax credit should be refunded. The provisions of the respective State VAT Acts will have to be studied. Most of the States have not provided for any refund and have only provided that the excess input tax credit may be carried over to the next tax period or year.

37. What is the net tax payable by a dealer who had not registered but Is later on found to be liable to pay tax?

An unregistered dealer will not be eligible to take credit for Input tax paid and will be liable to pay the entire output tax payable beside being liable for interest and penal action for failure to register. So dealers who are liable to tax must take care to register to be able to take input tax credit.

Sale Price

38. Is the meaning of "sale" under VAT different from the meaning of "sale" under the current sales tax laws? What are the transactions considered as "sale" under the VAT Act?

The definition of sale under the VAT Act will not be materially different from the definition under the sales tax Acts.

Section 2(37) of the Tamil Nadu VAT Act defines sale as 2 (37) "Sale" with all its grammatical variations and cognate expressions means every transfer of the property in goods, other than by way of mortgage, hypothecation, charge or pledge, by one person to another in the course of trade or business for cash, deferred payment or other valuable consideration and includes :-

(a) transfer, otherwise than in pursuance of a contract, of property, in goods for cash, deferred payment or other valuable consideration;

(b) transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) delivery of goods on hire purchase or any other system of payment by Installments;

(d) transfer of the right to use any goods for any purpose, whether or not for specified period, for cash, deferred payment or any other valuable consideration;

(e) transfer of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or any other valuable consideration;

(f) supply, by way of or as part of any service or in any other manner whatsoever, of goods being food or any other article for human consumption or any drink (whether or not intoxicating) where such supply or service is for cash, deferred payment or other valuable consideration;

(g) a 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, and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, deliver or supply and purchase of those goods by the person to whom such transfer, delivery or supply is made, but does not include a mortgage, hypothecation, charge or pledge.

Deemed sale like works contract have not been brought under VAT in certain States.

39. What are the "Sales" not liable to tax under the VAT Act ?

Since the VAT Act applies to only sales within the Stale, the following sales shall not be governed by the VAT Act.

a) Sale in the course of inter State trade or commerce which shall continue to be liable to tax under the Central Sales Tax Act, 1956.
b) Sale which takes place outside the State.
c) Sale in the course of export or import.

40. What constitutes "Sale Price" for charging of VAT?

Sale price is a term defined in the VAT Act and in the present sales tax Acts the meaning of the term was normally defined under the definition of the term "Turnover".

VAT Model Bill section 2(xvii) defines "sale price" as

(xxviii) "Sale price" means the amount of valuable consideration received or receivable by a dealer for the sale of any goods less any sum allowed as cash discount, according to the practice normally prevailing in the trade, but inclusive of any sum charged for anything done by the dealer in respect of the goods or services at the time of or before delivery thereof, excise duty, special excise duty or any other duty or taxes except the tax imposed under this Act;

The term sale price means the price charged in the bill net of discounts but includes any sum charged before the delivery of the goods. The following charges in respect of the goods before delivery will be included in "sale price":-

1. Basic price of the goods
2. Excise duty, if any
3. transport costs or freight, if any
4. clearing, forwarding and handling charges, if any
5. insurance charges, if any
6. taxes or duties levied under any law for the time being in force, by whatever name called, if any
7. cost of packing, if any

41. When does the liability to pay VAT arise in the case of a sale i.e., at the time of supply of the goods or at the time of raising of invoice or at the time of receipt of sale consideration?

The time of sale of goods is relevant for reporting of the turnover in the returns filed under the VAT Act.

This answer to this query is specifically provided in the Assam, Andhra Pradesh and Karnataka draft Acts only.

While in the Assam Act it is the earliest of the three events, in the Andhra Pradesh draft the time of sale of goods is the earliest of the raising of invoice or transfer of property in the goods.

In the Karnataka draft, the time of sale of goods is when the property in goods is transferred. Only in a case where the dealer has raised the tax invoice and has also received payment before the delivery of goods, the time of sale of goods is when the payment is received.

In the States where the time of sale of goods is not specified, the dealer may consistently take the date of invoice as the time of sale on the presumption that the property in the goods is transferred when the invoice is raised.

42. Will deposits, warranty fee received form part of sale price?

Refundable deposits for containers etc., do not normally from part of the sale price, unless otherwise provided in the definition of sale price. Please refer to the definition of sale price of your State VAT Act.

For instance, explanation (f) to the definition of sale price in section 2(44) of the Orissa VAT draft Act specifies as follows:

Amount received or receivable by the seller by way of deposit, warranty (whether refundable or not) which has been received or is receivable whether by way of separate agreement or not, in connection with or incidental to or ancillary to the sale of goods shall be deemed to be included in the sale price and the word "purchase price" with all its grammatical variations and cognate expressions, shall be construed accordingly;

The definition of the term sale price in the Assam draft includes a similar provision.

When the deposit is returned by the customer the VAT already charged must be refunded by issuing a credit note.

43. In Whose hands Is an accommodation sale liable to tax?

Where for accommodating a particular customer, a dealer obtains goods from another dealer and immediately disposes of the same to the said customer, the sale in respect of such goods shall be included in the turnover of the latter dealer but not in that of the former.

44. Can trade discounts be deducted from the sale price on which VAT is charged?

Sale price shall not include any amount allowed by seller of goods to the purchaser as cash discount or commission or trade discount at the time of sale of goods.

45. How is cash discount granted subsequent to the issue of Tax Invoice to be adjusted against the output tax?

When a cash discount or any other discount is given subsequent to the issue of the tax invoice, the selling dealer shall issue a credit note to refund the VAT already charged.

More on the issue of credit note is covered in the Chapter "Invoices, credit note and debit note".

46. Is barter or exchange a sale?

As in the present sales tax laws wherever there is a transfer of property in goods for consideration, there is a sale.

Rate of Tax and Goods Liable VAT

47. What are the rates of tax in VAT? What is Revenue Neutral Rate? What is Special Additional Tax?

The VAT rate of tax in most of the countries is a single rate. A single rate VAT is not immediately feasible in India. Though we had multiplicity of rates in the present Sales Tax in different States, the empowered Committee of Finance Ministers has agreed to the following rates of tax.

It is learnt that there may be two rates of 10% and 12.5% which will be made uniform in all the states in due course.

In the schedule to the VAT Acts of the respective States the goods liable to tax at 0%,1%,4% and the higher rates of tax will be listed. All goods liable to tax and not mentioned in any of the schedules will be subject to tax at the Revenue Neutral Rate"(RNR) or the General Rate.

The revenue Neutral Rate is the rate of tax for goods not specified in the other schedules at which the State Governments will realise the same revenue under VAT as it was collecting under the sales tax Act.

The general rate of tax advised by the empowered Committee is 10% to 12.5% initially as may be decided by the respective States. It is expected that within a period of 3 years all the States will adapt a single general rate of tax.

Some State Governments to offset partially the revenue loss on switch over to VAT have proposed a Special Additional Tax (SAT). SAT will be In addition to the VAT and is expected to be levied at the first point of sale only. While VAT will be eligible for input tax rebate at the hands of the subsequent buyer, SAT will not be eligible for Input Tax Credit.

48. Will the classification of Goods be uniform in all the State VAT Acts?

Ideally the description of various goods in all the State Acts should be ideal. It is learnt that the Empowered Committee for the guidance of the States will publish a HSN classification of exempt goods and goods taxable at 4%. Therefore the description of exempt goods and goods taxable at 4% is likely to be uniform throughout India.

49. Will all the goods be covered under VAT? If not, what are the goods that may not be covered under VAT?

The definition of "Goods" under the present sales tax Act and the VAT Acts is not different.

Goods have been defined in the Tamil Nadu VAT Act as follows:

Section 2(22) 'goods' means all kinds of movable proparty (other than news papers, actionable claim, stocks and shares and shares and securities) and includes all materials, commodities and articles including the goods (as goods or in some other form) involved in the execution of works contract or those goods to be used in the fitting out, improvement or repair of movable property : and all growing crops, grass or things attached to, or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Under the present sales tax Acts all "Goods" except sugar, tobacco and textiles which are subject to Additional Duties of Excise under the Additional Duties of Excise (Goods of Special importance) Act, 1957 are covered.

The inclusion or otherwise of the ADE Goods in VAT has not yet been decided. It is possible that these goods may be brought under VAT and Additional Duties of Excise may continue to be levied. A detailed answer on the ADE goods Is covered separately.

Certain goods like Lottery Tickets, Aviation Turbine Fuel (ATF), Certain petroleum products like crude oil etc., may be either kept out of VAT or Single point tax levied within the VAT structure. The details will be known only when the respective States enact the VAT Act and notify the Schedules.

50. Will the current levy of surcharge. Additional Tax etc, continue In VAT?

A number of States currently levy surcharge on sales tax, Additional sales tax or turnover tax in addition to the levy of sales tax. Under VAT all levies based on the sales turnover will be merged in the VAT rate.

All levies whose taxable event is the purchase or sale in the State and were part of the sales tax levy is expected to be discontinued.

51. Will Entry Tax AND Luxury Tax be continued to be levied in the VAT regime?

Entry tax is a levy of entry of goods into a Local Area and Luxury tax Is a levy on stock holding or consumption.

Currently, about 16 States impose Entry Tax on goods, 12 States impose Luxury Tax on goods, in addition to which a number of States impose Mandi Cess and a number of local bodies impose Octroi. The rates of each of these taxes vary widely between the States.

In Kelker's final report it is observed that it is a fact that local taxes such as Entry Tax, Octroi, Luxury Tax etc., in addition to Sales, Purchase and Turnover Taxes, are productive sources of revenue for many States, and that therefore, it would be difficult for the States to forego the revenue from these taxes.

However, Kelker has recommended that with the introduction of VAT, all other local taxes should be discontinued, and the same should be taken into account in determining the RNR.

However, It appears that Entry Tax Luxury Tax and oilier local levies like market cess on goods etc., would continue.

52. Under the present sales tax laws sale to electricity board and certain other institutions are subject to tax at 4% or as prescribed. Will the same concession continue?

The concession on sale to electricity Board, Railways etc., may have been given by a notification issued under the present sales tax Act. If the concession is to continue a notification under the VAT Act will have to be issued.

The issue in VAT would be that in the case of goods taxable at more than 4% , and if concessional rate of 4% is to be charged on sale to say, electricity board, the dealer effecting the sale will suffer with not being able to set off the full input tax credit.

One possible solution is not to grant concession, but permit such organisations to apply for refund of VAT paid in excess of 4% on local purchases.

53. Under the present sales tax Acts, concessional rate of tax of 3% is charged on raw materials by manufactures against submission of the relevant form. Will the same concession continue in VAT?

There will be no concession for industrial raw materials. The raw materials will be subject to VAT at the rate specified in the schedule to the VAT Act. It is expected that the basic industrial raw materials will be subject to tax at 4%.

One of the good features of VAT is that there will be no forms to be submitted, as there will be no concession. Even if concession to industrial raw materials is withdrawn, the manufactures will be benefited, as the tax paid on raw materials will be eligible for set off against the tax payable on the finished goods.

54. What are exempt transactions?

VAT is a tax levied on purchase or sale of goods in a particular State. Therefore as under the present sales tax Act, the following transactions as listed in section 45 of the Model VAT bill shall not be taxable under the VAT Act.

45. Sales not liable to tax:-

(1) Notwithstanding anything contained in this Act, a value added Sales tax shall not be imposed under this Act-

i. where such sales or purchase takes place in the course of interstate trade and commerce; or

ii. where such sale or purchase takes place in the course of interstate trade and commerce; or

iii. where such sale or purchase takes place in the course of import of goods into the territory of India or export of goods out of the territory of India.

(2) For the purpose of this section whether a sale or purchase takes place

i. outside the State ; or

ii. in the course of interstate trade and commerce; or

iii. in the course of import of goods into the territory of India or export of goods out of the territory of India

shall be determined in accordance with the provisions of section 3, section 4, and section 5 of the Central Sales Tax Act, 1956.

Sale in the course of interstate trade or commerce shall as before be governed by the Central Sales Tax Act, 1956.

55. What is a zero-rated sale? Is output tax payable on a zero rated sale?

Zero rated sales is a sale on which no tax is charged but input tax credit will be available as the following definition of the term Zero Rate Sale in Tamil Nadu VAT Act, 2003.

"Zero rated sale means a sale any goods on which no tax is chargeable but credit for the input tax related to such sales is admissible."

Export sale will be a Zero Rated Sale. While export sale is exempt, the exporter will get credit of Input Tax, which may be adjusted against output tax payable on any other sale or can be claimed as a refund.

56. What is the difference between exempt and zero-rated sale?

An exempt dealer pays VAT on his purchases , but he is not entitled to claim input tax credit as he does not pay VAT on his sales.

A dealer effecting Zero Rated Sales claims refund of the VAT paid on his inputs but pays no tax on his sale.

Declared Goods in VAT

57. What will be the rate of tax applicable on Declared Goods under VAT? Can declared goods be taxed at more than one point of sale?

Declared Goods are those declared to be goods of importance in the course of inter state trade as defined under section 14 of the Central Sales Tax Act, 1956

The rate of tax on declared goods shall not exceed four per cent as specified In clause (a) of section 15 of the Central Sales Tax Act, 1956 (74 of 1956).

Declared goods were earlier liable to tax only at one point of sale in the State. By the Finance Act 2002,the restriction on levy of tax at only one point of sale has been removed.

Therefore declared goods will be liable to VAT at every point of sale as any other goods with the only restriction that the rate of tax shall not exceed 4%.

58. What will be the liability to tax on Stock of declared goods that have already suffered tax within the state on date of transition to VAT?

Most of the State Acts provide for input tax credit of stock of goods on date of transition to VAT subject to restriction on the period of purchase of the goods prior to 01/04/2003.

In case of declared goods purchased prior to the date up to which input tax credit of tax paid under the present sales tax Act, no input tax credit will be available. If these goods are again subject to tax under the VAT Act the restriction under section 15 of the CST Act prohibiting levy of tax at a rate not exceeding 4% under the State Act will be violated.

Therefore there has to be a provision in the VAT Acts not to levy tax under VAT on stock of declared goods as on date of implementation of VAT as provided in the Model Draft Bill in Section 91- Transitional Provisions, reproduced below:

S. 91(g) Where a tax has been levied under any of the provisions of the repealed Act in respect of the sale or purchase of declared goods within the meaning of the section 14 of the Central Sales Tax Act, 1956 (74 of 1956), or any goods specified in Schedule IV before the appointed day, no tax shall be levied under this Act on sale or purchase of such goods on or after appointed day;

Please refer to the relevant provision in the respective State VAT Act.

AED Goods in VAT

59. What are AED goods? What will be their status in VAT?

Sugar, textiles and tobacco products are subject to Additional Duties of Excise under the Additional Duties of Excise (Goods, of Special importance) Act, 1957. Under an understanding between the Central Government and the State Governments the State Government shall not levy sales tax on these goods and the States will receive a share of the Additional Duty of Excise collected on these Goods.

It is reported in the press that the empowered committee has in the meeting held in the 3rd week of January 2003 decided to permit the levy of sales Sax by the states with effect from 1st June 2003. It Is reported that AED will continue to be levied on these goods at least till 2005. The floor rate of VAT on AED goods will be 1%. Therefore, there may be a dual levy on AED goods.

The Kelker Committee has in the Final Report recommended that whereas AED may continue for textiles upto 2005, it may continue even thereafter for cigarettes which should not be subjected to VAT.

Kelker's report has not said anything about sugar. If sugar is brought under VAT, Input tax credit of tax paid on sugarcane used in the manufacture of sugar may be blocked as otherwise the State Governments may face huge revenue loss.

Packing Materials in VAT

60. What is the liability to tax on packing materials in which the goods packed are either liable to tax or are exempt from tax?

When goods are sold In containers or packed in any packing material, the rate of tax applicable to such containers or packing materials, as the case may be, shall, whether the price of the containers or packing materials is charged separately or not, be the same as those applicable to the goods contained or packed therein and the turnover in respect of such containers and packing materials shall be included in the turnover of such goods.

When goods contained in container or packed in packing material is exempt from tax, then the sale of such containers or packing materials shall also be exempt from tax.

The one important point to be noted in the case of packing materials' used to pack exempt goods is that since no output tax is paid the Input Tax credit taken on the packing materials may have to be reversed.

Retail Dealers in VAT

61. Who is a retail dealer?

Retail dealer is not specifically defined in most of the State draft VAT Acts. In the Section titled "Presumptive Tax" or "composition of Tax", the meaning of the term retail dealer will be explained.

In Section 53(2) of the Model VAT Bill a retail dealer is defined as follows;

(2) For the purpose of this section a dealer will be considered to be engaged in the business of selling at retail if 9/10" of his turnover of sales consists of sales made to persons who are not dealers and if any question arises as to whether any particular dealer is a retailer, then the officer in charge of the case shall refer the question to the Deputy Commissioner (Appeals) who shall after hearing the dealer if necessary, decide the question.

62. Are retail dealers also required to pay VAT? If not, what is the alternative?

Most of the retail dealers are at present not liable to tax as In the single point system of levy of tax, the tax was paid by the first seller. The retailer as the second seller was not liable to tax though they were required to be registered under the State sales tax Act, if their turnover was above the minimum threshold limit for registration.

These dealers being small dealers may not be able to maintain the records required under VAT. Therefore the retails dealers below a threshold limit of annual turnover as may be specified in the respective State VAT Acts may opt for payment of tax at a flat rate of 1% or 2% as may be specified in the respective State VAT Acts.

The turnover limit for eligibility of retailers to opt for payment of tax at compounded rate of tax may be between Rs.20 lakhs to Rs.50 lakhs as may be specified by the respective States. All retail dealers with annual turnover above the limit specified will have to pay VAT even if their entire business is in retail.

The terminology is not uniform in all the States. The term “Presumptive Tax”, “Turnover Tax”, or “Composition of Tax” have been used to describe the levy of tax on retailers.

63. Are all Retail dealers eligible for payment of “Presumptive Tax”?

No, Only retail dealers with annual turnover below the limit specified shall be eligible. Retail dealers with turnover above the limit specified will not be eligible to opt for composition of tax.

64. Must all retail dealers who fulfill the turnover criteria opt only of General Registration instead of registering as a dealer liable for VAT?

The assessment at compounded rate of tax is optional. A retail dealer below the threshold limit may opt for registration as a VAT Dealer.

Where the retail dealer is In a business where the purchaser demands a VAT invoice / the retail dealer may out of business exigency be required to opt for payment of VAT.

65. Are retail dealers paying presumptive tax eligible for Input Tax Credit?

Dealers paying presumptive tax shall not be eligible for Input Tax Credit.

66. What is the rate of tax to be paid?

The rate of tax will be specified in the respective State VAT Act. The rate of tax is expected to be 1% or 2%.

67. What is the form of retail invoice to be issued?

There Is no specific form of retail invoice specified. The, particulars to be mentioned in a Retail Invoice will be specified in the VAT Act/Rules of the respective States.

For instance. Section 55(6) of the Model VAT Bill specify the following particulars to be Included in a Retail Invoice:

(6) The retail invoice shall contain the following particulars on the original as well as copies thereof, -

1. the words ‘Retail Invoice’ or ‘Cash Memo-random’ or ‘Bill’ in bold letters at the top or in a prominent place;
2. the name, address and registration certificate number of the selling registered dealer;
3. in case the sale is in course of export out of the territory of India, the name, address and registration number, if any, of the purchasing dealer/ foreign buyer and the type of statutory form, if any, against which the sale has been made;
4. an individual serialised number and the date on which the retail invoice is issue;
5. description, quantity, volume and value of goods sold inclusive of tax, charged thereon;
6. signature of the selling dealer or his servant, manager or agent, duly authroised by him;
7. the name and address of the printer, and last serial number of retail invoices printed and supplied by him to the dealer

68. How many copies of a Retail invoice are to be issued?

This will be provided in the respective State VAT Act/Rules.

The Model VAT Bill provides that Retail invoice shall be issued in duplicate. The original shall be issued to the purchaser and the duplicate copy shall be retained by the selling dealer.

69. What is the frequency of filing of returns by a retail dealer?

The frequency of filing of returns by a retail dealer may be monthly or quarterly as may be specified in the Rules of the respective States

70. Can a dealer, who has opted for payment of presumptive tax change the registration during the course of the year as a VAT Registered dealer?

Yes. The rules of the respective State will provide for the procedure.

71. Will the dealer be eligible for input tax credit on the stock of goods on the date of opting to pay VAT?

What is the procedure?

In the case. of mid year switch to VAT, the retail dealer will be eligible for input tax credit on stock of goods as on date of switch over to VAT and procured within a particular period as may be specified in the respective State VAT Act.

72. Can a dealer who has registered for payment of VAT opt to pay presumptive tax during the course of the year, if the dealer otherwise fulfils the conditions for payment of presumptive tax?

Such a contingency depends on the Rules framed by the respective State VAT Act. Normally a dealer who is not compulsorily required to register as a VAT dealer but has opted for VAT registration is required to continue as a VAT dealer for a minimum period of 1 year or 3 years as may be specified.

73. Is Input Tax credit eligible on second hand machinery?

There should be no restriction on availing of input tax on second hand,machinery as the sale will also be subject to VAT irrespective of whether Input Tax Credit has been availed or not.

However certain States like Assam have specifically provided that no person shall be entitled for input tax credit on capital goods if such person is the second or subsequent purchaser of such capital goods.

Please refer to the Section relating to Input Tax Credit of the respective State VAT Acts.

74. Can Input Tax Credit on eligible assets be claimed on purchase or on commissioning?

Most of the State, VAT Acts specify Input tax credit can be availed only on commencement of commercial production. This may apply to a newly set up unit. In the case of existing unit that add machinery after commencement of commercial production it is logical that input tax credit is claimed only on commissioning.

75. Is Input Tax Credit available on capital goods purchased from outside the State?

Input tax credit on CST paid on capital goods will not be available. The same provisions as applicable to traded goods and raw materials on CST paid applies to capital goods also.

76. Can Input Tax credit be availed in the month of commencement of commercial production or commissioning of the relevant capital asset?

Since the input tax credit on capital goods is likely to be substantial, the revenue of the Government may be affected adversely if credit is given in the month of commissioning. The input tax credit is therefore spread over a period of time. Please refer to the respective State Acts for the period specified.

77. I have purchased certain Capital Goods, which have not been commissioned, though I have commenced commercial production. Can I claim Input Tax credit on these capital goods?

The rules to be specified by the respective State will have to be referred to. In most of the State 'Acts commencement of commercial production is a prerequisite to claim input tax credit on eligible capital goods. So input tax credit can be claimed only on assets that have been commissioned and capitalised in the books of accounts.

After the rules are notified by the respective States there will be more clarity.

78. What is the eligibility of Input Tax credit on capital goods used partly for manufacture of goods subject to VAT and exempt goods?

Input, tax credit is eligible only on capital assets as defined in the VAT Act of the respective State and such eligible capital asset should be used in the manufacture or processing of taxable goods for sale as discussed In the answer to an earlier question.

In the Case of assets used partly for manufacture of taxable goods and partly for exempt goods, the input tax credit eligible for the tax period should be apportioned suitably. The basis of allocation is likely to be specified in the Rules.

It is expected that a general formula for apportioning Input tax credit will be hi prescribed. If the general formula is not applicable to any individual case, the rules may also provide for obtaining the prior approval of the department for the basis of apportionment subject to such conditions as may be specified.

79. Will input tax credit be available on capital goods that are used in the business as on the date of transition to VAT?

Input tax credit on capital goods on the date of transition to VAT will not be available unless the State VAT specifically provides for such credit.

80. A capital asset has been fabricated in the factory by purchasing components and sub assemblies. Can Input tax credit be taken on the material used in the fabrication of the capital asset?

Input tax should be eligible on the components and sub assemblies used in the machinery fabricated on commissioning and capitalising in the books of accounts, the capital asset should of course be an eligible capital asset and should be used in the manufacture of taxable goods for sale.

81. What is the tax liability on capital goods, say machinery, purchased from an unregistered dealer?

Purchase Tax is payable, if the State VAT Act specifies, where a dealer purchases any taxable goods from any person, not being a registered dealer and the said goods are used as capital assets anytime after such purchase at the rate of the tax leviable on the said goods,

Please refer to the section on "Purchase Tax" in the relevant State Act for liability to tax In the respective State.

82. Certain machinery on which I have claimed input tax credit are scrapped or given on lease as they are no longer required for my immediate business use. What is my liability to tax?

This is a question to be answered after the VAT Act and the Rules are brought into effect.

However, in case of scrapping of machinery there is no sale and no tax liability will arise. The scrap when sold will be liable to VAT at the applicable rate.

In case of leasing of machinery, the lease rental received will be liable to VAT if the transfer of right to use goods is liable to tax under the respective State VAT Act.

83. I am constructing a factory for which I purchase eligible capital goods from VAT registered dealers. What Is the procedure for accumulation of the VAT paid on machinery till the commencement of commercial production?

You will have to register as a dealer to be eligible to claim input tax credit on the capital goods. The input tax credit will be eligible for setoff only after commencement of commercial production over a period of time as may be specified in the respective State VAT Act.

There may also be a situation where the factory is under construction at present and the construction period spills into the period after implementation of VAT. Such dealers should also register under VAT to be eligible for input tax credit.

84. Is any specific register or record is to be maintained in respect of capital asset In respect of which Input tax credit has been availed?

Though a record of fixed assets Is maintained In the normal course of business, It Is advisable to redesign the register to Include columns for details of Input tax credit availed to substantiate the claim of input tax credit and for calculation of reverse credit. The rules of the State VAT Act will provide for any record to be maintained. Rule 24(7) of the Bihar VAT rules provides for maintenance of the following record

(7) Every dealer claiming rebate of input tax rebate on account of capital goods shall maintain a register in from VR-XIV of such goods containing the following particulars:

Location of the capital goods;

Date of purchase of the capital goods;

Quantity of the capital goods;

Cost of purchase of the capital goods;

Rate of depreciation applicable to the capital goods under the Income Tax Act, 1961;

Deemed Sales in VAT

85. Are deemed sales like works contract and Transfer of right to use goods liable to tax under VAT?

Currently in certain States Works contract and transfer of right to use goods are .taxed under a separate legislation while in other States the levy of tax is under the sales tax Act.

Though the Model VAT Bill provides for levy of tax on Works Contract and Transfer of right to use goods under the VAT Acts, Certain States may decide otherwise.

Please refer to the definition of "Sale" in the respective State Acts to confirm levy of tax on the deemed sales under the VAT Act.

The answers to the questions; that follow will be relevant only in case these deemed sales are liable to tax under the VAT Act.

86. What is the rate of tax payable on a works contract?

Works contract will be subject to tax as at present, i.e., only the material component will be liable to VAT and the charges towards labour, services and other like charges will not be liable to VAT subject to such conditions as may be prescribed. No tax will be levied in a works contract not involving the transfer of property in goods.

In the cases where the amount of charges towards labour, services and other like charges in such contract are not ascertainable from the terms and conditions of the contract, the amount of such charges shall be calculated at the prescribed percentage as may be provided in the Rules.

87. Will the option to pay tax at compounded rates be available in the VAT Act?

All the States where option to pay tax at compounded rates on works contract is available at present have included a provision for payment of tax at compounded rates in the VAT Act also.

88. When does the liability to tax accrue on the case of works contract?

The answer to this question will be found in the section titled "Time of sale of goods" in the respective VAT Acts.

If this is not provided for specifically in the State VAT Act, the liability to tax on works contract will arise at the time of transfer of property in goods which may be at the time of delivery of the goods or incorporation of the goods in the Works Contract as per the terms of the agreement regulating the transfer of property in goods.

89. When does the liability to tax accrue on the case

of transfer of right to use goods?

The answer to this question will be found in the section titled "Time of sale.of goods" in the respective VAT Acts.

In the absence of any specific provision, the transfer of property in goods in the case of transfer of right to use goods is deemed to have occurred on the date the right is transferred.

90. What is the eligibility of input tax credit on goods liable to tax as transfer of right to use goods?

Input tax credit on goods used in the execution of works contract shall be eligible unless specifically excluded.

Please refer to the section titled "Input Tax Credit" in the respective State Acts for any specific exclusion. Only Assam and Uttaranchal have specifically excluded goods used in the execution of works contract.

Considering that the consensus is to grant input tax credit, these States may also amend the provision in the final VAT Act.

91. How are the goods to be invoiced in the case on ongoing works contracts that have not been completed as on 31/03/2003?

In the case of Works contracts that have not been completed as on 31/03/2003, there is a need for careful planning to avoid confusion as to whether the transfer of property in goods should be invoiced under the present sales tax Act or under the VAT Act.

Where there had been transfer of property in goods prior to 31/03/2003 as per the respective sales tax, the invoices in respect of those goods may be raised under the present sales tax Act.

The goods not Invoiced but are in the works site will normally be reflected in the closing stock of the contractor as goods at site. Such goods shall also be eligible for input tax credit of the tax paid under the present sales tax Act as per the provisions of the respective State VAT Act. Therefore a proper Inventory of goods at site with relevant purchase invoices should be maintained.

Please refer to the respective State VAT Act for eligibility of input tax credit on ^ stock of goods as on 31/03/2003.

Consignment Despatch / Branch Transfer in VAT

92. Will there be any change in the exemption on Consignment despatch/ Stock Transfer to outside the State?

Inter State Stock Transfer is regulated by the provisions of the Central Sales Tax Act and not by the State Sales Tax Act or VAT Act. There is no change in the presently available exemption on inter State Branch Transfer/Consignment despatches.

It is to be noted that by an amendment to the Central Sales Tax Act, the filing of Form-F is mandatory now.

However there will be restrictions on availing of Input Tax Credit with reference to both traded goods and manufactured goods despatched on Stock Transfer/Consignment despatch to outside the State.

93. Is input tax credit available on goods stock transferred? If Ineligible will the input tax credit relating to the goods stock transferred lapse?

There had been lot of discussion on the availability of Input Tax Credit on goods stock transferred. Since goods stock transferred are not subject to tax the States were reluctant to give input tax credit. The consensus now is that the States shall give input tax credit of tax paid on purchases in excess of 4%. By blocking of input tax credit of 4%, the goods stock transferred are Indirectly taxed at 4% of the purchase value.

In the case of raw materials used in the manufacture of goods that are despatched on stock transfer, input tax credit on raw materials shall be eligible for tax paid in excess of 4%.

Though the draft VAT Acts of certain States provide for no input tax credit on goods despatched on stock transfer, it is expected that the provision for set off will be incorporated in the final VAT Act.

Section 17(8) of the Model VAT bill provides as follows:

17(8) No input tax credit under sub-section (1) shall be claimed or be allowed to a registered dealer

ix. in respect of goods used for transfer of stock other than by way of sale outside the State of ________________;

x. ...

xi. in respect of raw materials used in manufacture or processing of goods where the finished products are despatched other than by way of sales :

Provided that in respect of transactions falling under item (ix), input tax credit may be allowed on the tax paid in excess of 4% on the raw materials used directly in the manufacture of the finished products.

The manner of computation of the disallowance is not clear. There are likely to problems in computation of disallowance when a number of raw materials are used for the manufacture of a single product. The rules need to be properly framed for computation of the input tax credit eligible.

The 4% input tax credit if already taken will lapse and will have to be reversed.

INTERSTATE SALES IN VAT

94. What happens to the Central Sales Tax?

The VAT Act governs only sale of goods within the State and replaces the existing sales tax Act. Inter State sale will continue to be regulated by the Central Sales Tax Act, 1956.

Inter State sale will continue to be liable to tax at 4% against Form C/D and the rate of tax on transactions not covered by Form C/D shall be subject to tax at the VAT rate of tax.

The statutory Form C/D,E1,E2,F and H shall continue to be remain applicable.

However, in future, it is expected that the tax rate for sale against C form shall be gradually reduced from the present 4% to 0%.

108. What is the format of Invoice for inter State Sale?

As discussed, in the chapter on “Invoices”, a local sale by a VAT registered dealer shall be covered by a VAT Invoice containing the particulars specified. Since an Inter State sale is not a sale under the VAT Act, a VAT invoice shall not be issued for an inter state sale. An invoice in the normal format used in the business as at present shall be issued.

EXPORT SALES IN VAT

95. Is there any change in the current exemption for export of goods out of India?

The actual export sale will continue to be exempt as at present.

96. What will be the status of the current exemption for sale penultimate to export out of India under Section 5(3) of the CST Act?

Under the present sales tax Act the exporter purchases goods for export without payment of tax as provided in section 5(3) and on fulfilling the condition that the good should have been purchased for the purpose of export against a pre existing foreign buyer’s order. The exporter is required to submit form-H to his seller.

Under VAT, the export sale will be zero rated, i.e., while no tax will be levied on the export sale the exporter can claim refund of the tax paid on the purchase of the goods for export. In the circumstances, the exemption for sale penultimate to export will be redundant and form H procedure need not continue.

However if Section 5(3) of the CST Act is not amended or deleted, the actual exporter will continue to purchase goods against form-H and the sale of goods to the exporter against Form-H will also be zero rated.

Since section 5(3) is redundant in the VAT scenario, section 5(3) may be made inapplicable from 01/04/2003.

97. Export sale is said to be Zero Rated. What does it mean?

In VAT terminology, a zero rated sale is one which is not liable to tax but is eligible for refund of input tax credit. There export of goods out of India is exempt and the exporter can claim refund of the Input Tax Credit.

98. What is the procedure for claiming refund of Input Tax Credit on export sales?

The input tax credit eligible on export of goods out of India may be either claimed as a refund or adjusted against any other output tax liability of the exporter.

The procedure and the forms for claiming refund will be specified in the State VAT Rules.

99. What are the records to be submitted to claim refund of Input Tax Credit on export sale?

The VAT Rules of the respective States will provide for the documents to be produced in support of claim of refund.

Rule 15 of the Andhra Pradesh draft Rules specifies as follows:

In the case of international exports the following documents shall be retained for the claim for zero- rating to be allowed.

1. Copy of the invoice issued to the foreign purchaser.
2. Transport documentation i.e. Bill of Lading, Airway Bill, or similar document.
3. Evidence of payment from the foreign purchaser. Where this evidence is not immediately available a bank guarantee equal to the amount of the refund claimed shall be provided.

100. Is there any change in the present exemption for sale/purchase In the course of import of goods into India?

There is no change in the exemption of levy of tax on purchase/sale in the course of import of goods from outside of India.

If the goods are sold subsequent of import into India VAT should be paid at the rate of tax applicable to the relevant goods.

ENTRY TAX IN VAT

101. In several States Entry Tax is levied at present. Will the levy continue in the VAT regime ?

Though trade and industry have been making strong plea for scrapping of entry tax on implementation of VAT, it looks unlikely that entry tax will be scrapped. Levy of entry tax will continue at least for the present. The State governments justify the continuance of Entry Tax as necessary to partially offset the revenue loss on transition to VAT.

102. Will the levy of entry tax be integrated in the VAT Act ?

Only In the Delhi VAT draft the levy of entry tax was integrated in the VAT draft Act. Since the taxable event in the VAT Act and the Entry Tax Act is different it may not be advisable to integrate Entry Tax in the VAT Act. It is expected that in the revised draft of the Delhi VAT Act, the integration of levy of Entry Tax in the VAT Act may be removed.

103. Will input tax credit be available on entry tax

paid?

In the draft Acts published so far the set off of Entry Tax in the VAT Act has been provided in the Bihar Act and Delhi Act.

Though Entry tax is levied by a number of Slates, the provisions of the Act are not uniform in all the States. In some States, a nominal entry tax of 1% or 2% is levied and no set off is given against the present sales tax payable. In some States like Tamil Nadu, the Entry tax rates correspond to the rate of tax under the Sales Tax Act and set off of entry tax is available against resale of the goods. Setoff of entry tax paid on raw materials is given only to specified goods. Further the provision for set off of entry tax against the sales tax liability is provided in the Entry tax Act itself and not in the sales tax Act.

Therefore one has to read the entry tax Act along with the VAT Act to confirm eligibility of set off of entry tax paid.

PURCHASE TAX IN VAT

104. Under the current sales tax Act, purchase tax is levied on goods in certain circumstances. Currently the liability to purchase tax is not on the purchase but when used or disposed off in the manner specified in the section levying purchase tax. How is tax to be paid on such goods when liable to purchase tax under the VAT Act?

Purchase tax levied under the present sales tax Acts is continued under VAT also. The only difference in the different State VAT Act are the circumstances in which purchase tax is attracted. Please refer to the Section on "Purchase Tax" or "Levy of tax on purchases" in the respective State VAT Act.

The mode VAT Bill provides for levy of purchase tax in Section 10 which is self explanatory.

10. Levy of tax on purchases -

Every dealer who in the course of his business purchases any goods. i. from a registered dealer in the circumstances in which no tax under section 9 is payable by that registered dealer on the sale price of such goods, or

ii. from any other person,

shall be liable to pay tax on the purchase price of such goods, if after such purchase, the goods are not sold within the State of _______ or in the course of inter-State trade and commerce or in the course of export out of the territory of India, but are

a. sold or disposed of otherwise, or

b. consumed or used in the manufacture of goods declared to be exempt from tax under this Act, or

c. after their use or consumption in the manufacture of goods, such manufactured goods are disposed of otherwise than by way of sale in the State of __ or in the course of inter-State trade and commerce or export out of the territory of India; or

d. used or consumed otherwise,

and such tax shall be levied at the same rate at which tax under section 9 would have been levied on the sale of such goods within the state on the date of such purchase.

105. Will input tax credit be available on the purchase tax paid?

Input tax credit is applicable only when tax has been paid on purchases from another dealer. However the purchase tax paid can be adjusted against the output tax payable as provided for in Section 16 of the Model VAT Bill.

16. Tax payable:-

(1) The net tax payable by a registered dealer for a tax period shall be the difference between the output tax plus purchase tax, if any, and the input tax, which can be determined from the following formula:

Net tax payable = (0+P)-I

Where '0' denotes the output tax payable for any tax period as determined under section 14, 'P' denotes the purchase tax paid by a registered dealer for any tax period as determined under section 10 and 'I' denotes the input tax paid or payable for the said tax period as determined under section 15.

106. A dealer may have in Stock on date of transition to VAT goods purchased which had not suffered purchase tax as the circumstances specified in the sales tax Act had not occurred. Will the goods be liable to purchase tax under the VAT Act?

The relevant State VAT Act provisions relating to Transition Provisions will have to be referred to.

Even in the absence of a specific provision, the goods will be liable to purchase tax under the VAT Act if the conditions specified in the section levying purchase tax are fulfilled.

PURCHASE / SALES RETURN

107. A dealer has taken credit for input tax in respect of the purchases In a tax period. The goods are rejected and returned. How is the transaction to be accounted?

The dealer shall return the goods to the seller and issue a debit note specifying the VAT relevant to the goods returned. The dealer who receives the returned goods shall issue a credit note.

Both the dealers shall account for VAT in the monthly returns based on their respective credit note/debit note.

There will a restriction on the period within which a debit note/credit note shall be issued as may be provided in the VAT Act/Rules of the respective States. For instance in Andhra Pradesh draft, the time limit is six months from the date of sale of the goods to which the debit note/credit note relates.

108. Will there be any change in the procedure of payment of tax in respect of sale effected by an agent on behalf of an within the State principal?

There will be no change in the procedure of payment of tax by the agent who effects the sale on behalf of a principal whether disclosed or not.

The principal will include the sale by the agent in the gross turnover and claim exemption on the sale by the agent with proof of payment of tax by the agent. There will a form of declaration or affidavit to be given by the agent to the principal in proof that the VAT has in fact been paid by the agent.

109. Can the transfer of goods from the principal to the agent be deemed to be a sale?

Normally there is no transfer of property in goods and consequently no sale when goods are entrusted to the agent for sale. But there may be circumstances when a sale from one person to another may be disguised as a sale to avoid payment of tax. In most of the VAT draft Acts an explanation similar to Explanation III to the definition of sale in section 2(29) of the Andhra Pradesh draft VAT Act which provides that in the following circumstances the transfer of goods from a principal to an agent shall be deemed to be a sale.

Explanation III: - Notwithstanding anything contained in this Act or in the Indian Sale of Goods Act, 1930 (Central Act III of 1930), two independent sales or purchases shall for the purposes of this Act, be deemed to have taken place.

(1) When the goods are transferred from a principal to his selling agent and from the selling agent to his purchaser, or

(2) When the goods are transferred from the seller to a buying agent and from the buying agent to his principal, if the agent is found in either of the cases aforesaid.

(i) to have sold the goods at one rate and have passed on the sale proceeds to his principal at another rate; or

(ii) to have purchased the goods at one rate and to have passed them on to his principal at another rate; or

(iii) not to have accounted to his principal for the entire collections or deductions made by him, in the sales or purchases effected by him on behalf of his principal; or

(iv) to have acted for a fictitious or non-existent principal;

110. The principal who sends the goods for sale to an agent would have claimed input tax credit. But the agent effects the sale. Who shall be entitled to input tax credit in respect of the goods sold by the agent?

Input tax credit shall be eligible to be set off against the output tax only in the event of a taxable sale either within the State or outside the State. In case of despatch to an agent there is no sale and therefore, logically, the principal will not be eligible for set off of input tax credit and will have to reverse the input tax credit.

Then what happens to the Input tax paid on the goods sold by the agent? Since the agent has paid the output tax, the agent should be eligible to set off the input tax paid by his principal.

What is stated herein above is opinion. However this aspect is not clearly spelt out in the VAT draft Acts published so far. Please refer to the provisions of the VAT Act of your State.

BAD DEBTS DEDUCTION

111. Is there any deduction for bad debts? i.e., if the sale proceeds of an Invoice is not capable of being collected and is written off as a bad debt, can the dealer claim refund of the VAT paid?

Relief for bad debts is a normal feature available internationally under VAT. In , India, under the present sales tax dispensation refund of sales tax paid on sales return within a period of six months from the date of sales is available. This is provided for the VAT draft Acts.

Relief for Bad debts is provided only in the West Bengal draft Rules in Rule 54. Since a similar provision needs to be incorporated in the rules of other States as well, the full text of the rule is reproduced below.

54. Deduction of sale price goods return and bad debt for computing gross turnover of sales for subsequent return period.

Where,-

(a) any goods are returned by a customer to a registered dealer within six months from the date of purchase, during or following the period in which such goods were sold,

(b) sale price of goods sold by a registered dealer during a period is written off as bad debt during any subsequent period following the period in which such goods were sold,

such registered dealer may, while furnishing return under rule 49 or rule 50 or rule 53, as the case may be, deduct from his gross turnover of sales of goods-

(i) sale price of the goods so returned in respect of which due tax has been paid by the dealer during the earlier period referred to in clause (a);

(i) sale price of the goods written off as bad debts in respect of which due tax has been paid by the dealer during the earlier period :

Provided that the deduction with respect to bad debt referred to in item (ii) above shall be certified by a Chartered Accountant to the effect that such sale price has become irrecoverable from the customer and accordingly it has been written off as bad debt in a subsequent period.

TRANSITION TO VAT

112. Will input tax credit be available on stock of traded goods and raw materials in stock as on 31/03/2003?

With the implementation of VAT from 01/04/2003, all sale of goods will be subject to tax under the VAT Act. Under the VAT Act the tax paid on inputs can be setoff against the output tax payable. The stock of goods as on 31/03/2003 have not suffered tax under the VAT Act. Will input tax credit be available?

Yes. The tax paid under the present sales tax Act will be eligible for credit subject to such terms and conditions as may be specified in the respective State VAT Acts. Unfortunately, there is no uniformity in the provisions of the different State VAT Acts.

The issues that arise are

1. Will the tax paid on the entire stock be eligible for input tax credit Irrespective of the date of purchase of the goods?
2. What is the tax amount that will be eligible for input tax credit, the tax calculated at the rate applicable under VAT or the tax actually paid under the sales tax Act?
3. Some of the purchase invoice will not have details of the tax rate applied and the tax amount paid as the purchase may be from a dealer In whose hands the sales is not liable to tax as second sale. What will be the tax credit eligible in such cases?
4. What are the records required for substantiating the claim of input tax credit?

113. Can the input tax credit of stock brought forward be claimed in the first return filed under the VAT Act?

The credit can be taken as specified in the respective State VAT Act. The credit may not be allowed in the first month since the claim of input tax credit on stock may be substantial. The claim is likely to be spread over a period commencing, say, three months after 01/04/03.

The three months period is for the department to verify and accept the claim.

114. Any special word of caution on claiming input tax credit on stock of goods on 31/03/2003?

The dealers need to plan pre VAT inventory properly to be able to submit the declaration in time.

Care should be taken to avoid mistakes as heavy penalty has been proposed in some of the State VAT Acts for misdeclaration in the stock statement.

115. We have with us stock of tax suffered declared goods which are subject tax only at the point of first sale. Do we have to charge VAT on the sale of the tax suffered declared goods after 01/04/2003?

Most of the State Acts provide for input tax credit of stock of goods on date of transition to VAT subject to restriction on the period of purchase of the goods prior to 01/04/2003.

In case of declared goods purchased prior to the date upto which input tax credit of tax paid under the present sales tax Act, no input tax credit will be available. If these goods are again subject to tax under the VAT Act the restriction under section 15 of the CST Act prohibiting levy of tax at a rate not exceeding 4% under the State Act will be violated.

Therefore there has to be a provision in the VAT Acts similar to Section 91(g) of the Model VAT Bill reproduced below:

Sec 91(g) Where a tax has been levied under any of the provisions of the repealed Act in respect of the sale or purchase of declared goods within the meaning of the section 14 of the Central Sales Tax Act, 1956 (74 of 1956), or any goods specified in Schedule IV before the appointed day, no tax shall be levied under this Act on sale or purchase of such goods on or after appointed day;

Please refer to the relevant provision in the respective State VAT Act.

116. We have with us certain forms like Delivery Note, Way Bill etc., which are to be obtained only from the department? Will different forms be notified under VAT? Can we continue to use the forms obtained under the current sales tax Acts also from 01/04/2003 when VAT Act comes into force?

Since some of these forms are printed and supplied by the Commercial Taxes department, it may not be possible to make available the new forms as may be prescribed on 01/04/2003 itself. Therefore almost all the State VAT Acts have provided that the form currently in use may be continued to be used till notified otherwise.

117. In the case of ongoing sales existing 31/03/2003, supply of goods in respect of spills into the period from 01/04/2003, how is how is the transaction to be invoiced and VAT to be paid?

To avoid confusion it may be advisable to invoice the sales upto 31/03/2003 as per the provisions of the present sales tax Act and invoice the sale thereafter under the VAT Act.

EXISTING TAX CONCESSIONS IN VAT

118. What are the different types of sales tax concessions presently available in different States of India?

No fresh incentives have been granted by any of the States after 01/01/2000. 'The different kind of incentive schemes granted earlier and likely to continue in some cases upto even 2020 falls in the following categories.

- Exemption from payment of sales tax for a specified period based on investments made.
- Deferment of tax. The unit will charge sales tax in the invoices but will retain the sales tax as a loan to be

repaid without interest after a specified period.

- Exemption on payment of tax on raw materials, capital goods and other inputs.
- Tax exemption as well as exemption on payment of tax on inputs
- Remission of tax. Under the remission model the manufacturer will charge VAT in the invoice, file the monthly return but retain the tax towards the incentive receivable by the unit.

119. Will the exemptions/ deferment of tax continue in VAT7

The continuance of tax exemptions either on sale or purchase is incompatible in .the VAT Regime. The continuance of deferment of tax poses no problem, as the selling dealer will charge VAT in the sale invoices. The tax so collected is treated only as a loan.

The problem is with reference to units that enjoy tax exemption on sales or purchases. The present proposal is to convert the units currently enjoying, exemption to deferment of tax with 30% enhancement of the amount and period sanctioned under the incentive scheme. This will not be acceptable to Industry, as it may not compensate adequately the exemption these units would have otherwise enjoyed.

The issue of treatment of sales tax concessions on sale/ purchase has not been resolved yet.

120. Are dealers already registered under the present sales tax Act required to apply for fresh registration as a dealer under VAT?

Yes. However to ensure continuity in the registration and payment of tax under the VAT Act most of the State VAT Acts have provided for deemed provisional registration of existing dealers. All such dealers are required to file an application for registration under the VAT Act within a specified period of one month (or as specified in the respective State VAT Act)

A dealer who is currently registered under the present sales tax Act may not opt for registration under VAT only if he anticipates his turnover to be below the minimum threshold limit for registration specified in the respective State VAT Act.

121. What happens when an existing dealer under the present sales tax Act fails to apply for fresh registration as a dealer?

Existing dealers are required to apply for registration within a specified time. Some of the State Act (eg., Pondicherry) provides that existing dealers who fail to apply for registration shall be deemed to registered as if an application had been made by the dealer.

Dealers, to be eligible for input tax credit on stock of goods on 31/03/2003 and on subsequent purchases should check the time limit to apply for registration under the VAT Act and submit the application in time.

Penalty will also be leviable for failure to register.

122. What is the basic exemption limit for registration?

There is no uniform limit for registration agreed to on an all India basis. Please refer to the respective State Act.

123. What are the different types of registration under the VAT Act?

The different types of registration specified in the draft Acts are Deemed registration, Compulsory registration, Voluntary registration and Provisional Registration.

The Deemed registration provisions are not explicitly state in some of the State VAT Acts. However Acts provide that all dealers who had been registered under the present sales tax law and who are otherwise liable for registration under the VAT Act, shall be deemed to be registered under the VAT Act. These dealers are however required to submit an application for registration under the VAT Act. Of course, the dealers who discontinue their business after 01/04/2003 may notify and will not be required to register.

Compulsory registration provisions cover the following category of dealers who must register under the VAT Act.

a) Dealers whose turnover is above the minimum threshold limit for registration.

(b) Dealers who are deemed to be registered as explained herein above

(c) Every dealer importing goods in the course of business from outside the territory of India.

(d) Every dealer registered or liable to be registered under the Central Sales Tax Act 1956, or any dealer making purchases or sales in the course of inter-state trade or commerce or despatches any goods outside, the State otherwise than by way of sale,

(e) Every dealer residing outside the State but carrying on business within the State and not having any permanent place of business;

(f) Every dealer liable to pay Special Additional Tax (if specified in the respective State VAT Act)

(g) Every commission agent, broker, delcredere agent, auctioneer or any other mercantile agent by whatever name called, who carries on the business of buying, selling, supplying or distributing goods on behalf of any non resident principal.

(h) Every dealer availing industrial incentive in the form of a tax holiday or tax deferment.

Voluntary Registration means that a dealer who is otherwise not required to compulsory register may apply for registration under the Act due to business exigencies. A dealer's turnover may be below the threshold limit for registration, but his customers may require a VAT invoice to avail of Input Tax Credit and it makes business sense for such dealers to opt for voluntary registration.

Provisional Registration is provided for in some of the States for intending manufacturers till they are liable to compulsorily register.

124. How is the registration limit computed? i.e., on the basis of turnover for 2002-03 under the sales tax Act or on any other basis?

The rules of the State VAT Act will provide for the manner of computation of turnover. Some States have specified that the threshold limit is to be calculated on a consecutive 12 months basis or on a quarterly basis by dividing the turnover limit per quarter.

125. What are the consequences of a dealer who is liable for registration after the coming into force of the VAT Act but has failed to register?

In the case of an existing dealer under the present sales tax Act the deemed registration provisions will apply.

In the case of a dealer who becomes liable to register after the coming into force of the VAT Act but fails to register, the dealer will nevertheless be liable to pay VAT as applicable and will also face penal consequences. Besides the dealer runs the risk of losing input tax credit for the period he had failed to register.

Records To Be Maintained Under VAT

126. We are currently maintaining books of accounts as per normally accepted practice and have been accepted so far in Income Tax and sales Tax proceedings. Will introduction of VAT require maintenance of any additional records?

Introduction of VAT will not cast any additional burden of maintenance of books of accounts for dealers who are currently maintaining proper books of accounts The records to be maintained will be specified in the rules of the respective State VAT Rules.

The books of accounts to be maintained by a VAT registered dealer as specified in Rule 13 of the Andhra Pradesh draft VAT rules are

13. Records to be maintained for VAT.

i. Every taxable person/person shall keep and maintain a true and correct account of his taxable transactions in any of the languages specified in the VIII Schedule to the Constitution or in the English language.

ii. The following records in particular shall be maintained:

a. A VAT monthly account specifying total output tax, total input tax and net tax payable or the excess tax credit due for refund or carry forward.

b. Purchase records, showing details of all purchases on which tax has been paid and all purchases made without payment of tax. Original tax invoices for purchases on which tax has been paid, and invoices for purchases made without payment of VAT shall all be retained in date and numerical order.

c. Sales records showing separately all sales made at each tax rate, Zero-rate taxable sales and exempt sales. Copies of tax invoices related to taxable sales and invoices related to exempt sales shall all be retained in date and numerical order.

d. Credit and debit notes issued and received shall all be retained in date and numerical order.

e. Record of all zero-rated export of goods together with copies of invoices issued to the foreign purchasers, transport documentation in the case of export of goods, form 1-1 prescribed under the CST Act orders or contracts for or with the foreign purchaser, and evidence of payment by bank transfer through a bank registered in the State of Andhra Pradesh or by a letter of credit payable by a bank.

f. Record of inter-State sales and inter-State transfer supported by C forms, F forms, Waybills and stock transfer vouchers.

g. Cash records maintained by retailers namely cash books, petty cash vouchers, and other account records including copy receipts or cash register machine rolls detailing the daily takings.

h. Computer records, where available.

i. Details of input tax calculations where the taxable person is making both taxable and exempt sales.

j. Documents, records, and claim forms for all transitional relief claims of tax credit for sales tax.

k. Stock records showing stock receipts and deliveries and any manufacturing records.

l. Order records and delivery notes.

m. Business correspondence.

n. Appointment and job books.

o. Annual accounts including trading, profit and loss accounts, the balance sheet and various sales of complementary information.

p. Bank records, including statements, cheque book counter foils and pay-in-slips.

All records specified in sub-rule (ii) of this Rule shall be in the form prescribed or recognized by the Commercial Taxes Department, and shall be retained and made available for Inspections for a period of 6 years.

Every taxable person who keeps and maintains the accounts in a language other than English shall adopt international numerals in the maintenance of such accounts.

Every person registered under this Act is required to issue either a VAT invoice or a sale bill or cash memorandum, and maintain a separate record of dally sales at each rate of tax, including exempt sales".

127. Can books of accounts be maintained as an electronic record?

Books of accounts may be maintained in a computer. There should of course be a proper procedure for back up copy of the records.

Invoices, Credit Note and Debit Note

128. What are the different types of invoices under VAT?

There are two types of Invoices under VAT, Tax Invoice or VAT Invoice and Retail Invoice.

A Tax Invoice or VAT invoice can be issued only by a VAT registered dealer in the circumstances specified.

Tax Invoice has been defined as follows in section 2 (xxxi)ofthe Model VAT Bill

"Tax invoice" means a document listing goods sold with price, quantity and other details as specified in this Act and includes a statement of account, bill, cash register, slip, receipt or similar record, regardless of its form;

A retail invoice is to be issued by a dealer who has opted for payment of Presumptive Tax as a retail dealer.

129. Will there be any prescribed form of Invoice to be issued? Can the same form of invoice issued by manufacturers for excise purposed be continued to be used as a VAT Invoice also?

No format of invoice is specified in the VAT Act or Rules. However the particulars to be contained in a Tax Invoice or a Retail Invoice will be specified in the VAT Act/Rules.

The present format of invoice can be used. But care should be taken to include the particulars specified in the VAT Act/Rules of the respective States.

130. How are mistakes like excess billing or short billing to be invoiced? Is there any time limit for issue of Credit Note/Debit Note?

Mistakes in the issue of invoice may be rectified by the issue of a credit note or debit note as the case may be.

There may be a time limit for issue of Credit Note/Debit Note specified in the VAT Rules of the respective States. For instance Andhra Pradesh VAT Rules (Rule 12) specify a time limit of six months from the date of original sale for issue of debit note/credit note.

This time limit does not mean that a dealer cannot recover or adjust any mistake In raising of invoice or adjustment for goods returned or excess/short supply. The restrictions in the rule is with reference to the eligibility to take credit of VAT In the credit/debit notes.

131. What are the circumstances in which a credit note or debit note is to be issued?

Section 23 of the Model VAT Bill provides that a credit note or debit note should be issued in the following circumstances.

23. Credit notes and Debit notes:-

(1) Where a tax Invoice has been issued and the amount shown as tax charged in the tax invoice exceeds the tax payable under this Act in respect of that sale the registered dealer making the sale shall provide the purchaser with a credit not containing the requisite particulars as may be prescribed.

(2) Where the tax invoice has been issued and the tax payable under this Act in respect of the sales exceeds the amount of tax charged in that tax invoice the registered dealer making the sale shall provide the purchaser with a debit note containing the requisite particulars as may be prescribed.

(3) In case of goods returned or rejected by the purchaser, a credit note shall be issued by the selling dealer to the purchaser and a debit note will be issued by the purchaser to the selling dealer containing the particulars as may be prescribed,

Any registered dealer Who receives or issues credit notes or debit notes shall modify his return for the period in which the credit note or debit note is issued and pay any tax due on, such return.

Returns Under VAT

132. Will the procedure for, filing of returns, revised return etc., be different from the present procedure under the existing Sales Tax Acts?

The procedure for filing of returns, time limit for filing of returns etc., will not be materially different from what is provided in the present sales tax Act.

The form of return will be as prescribed in the VAT Act/ Rules.

Auditing of Accountancy by Chartered Accountants

133. Will there be any material difference between the present system of assessment and the assessment procedure under VAT?

The self-assessment limit under VAT is more liberal than under the present sales tax Acts in view of the inherent self policing mechanism and audit trial in the VAT system.

Another difference as provided in the VAT Act of different States is that the assessment will be carried out in the premises of the dealer as opposed to the present practice of taking the book? of accounts to the assessing office as in vogue In many of the States.

134. What is the turnover limit for auditing of Accounts by Chartered Accountants?

Since,the turnover limit for self assessment will be higher, auditing of accounts by chartered accountants is provided for in all the State VAT Acts, The turnover limit specified in the VAT draft Acts published are as follows:

State	Annual Turnover exceeding Rs.
Andhra Pradesh	Every VAT Dealer
Assam	40 lakhs
Bihar	40 lakhs
Chattisgarh	40 lakhs
Karnataka	25 lakhs
Manlpur	20 lakhs
Madhya Pradesh	40 lakhs
Orlssa	40 lakhs
Pondlcherry	40 lakhs
Punjab	To be prescribed
Uttaranchal	25 lakhs

The audit report is required to be filed by the 30th of October for the previous year ending March.

At present, in some of the States like Tamil Nadu the filing of Chartered Accountant's report and opting for self assessment is optional. Under VAT filing of audit report Is likely to be mandatory. Penalty will be levied for failure **to** submit the audit report within the time specified.

The due date for filing of audit repot and penalty differs from State to 'State. Please refer the draft VAT Act of the respective States.

Appeals Under VAT

135. Will the provisions relating to appeals against assessment be different under the VAT Act?

The same hierarchy of appeals as in the present sales tax Acts have been provided in the draft VAT Acts of different States.

Generally/the hierarchy of appeals is First appeal to the Appellate Assistant Commissioner or Appellate Deputy Commissioner

Second Appeal to the Appellate Tribunal

Appeal to the High Court or to the Special Taxation Tribunal

Appeal to the Supreme Court

Stock Transfer Vs Direct Sales

136. In the VAT regime, will stock transfer be more beneficial than inter state sale?

In so far as a decision as to whether goods should be stock transferred and then sold to customers by the branch or should direct Inter State Sales be effected, there can be no generalisation. The decision has to be taken on a VAT impact Analysis of each individual business. The tax Implication to be considered are:

1. In the case of inter State sale the buying dealer has to pay a non vattable CST while the selling dealer will get the benefit of input tax credit.

2. In the case of stock transfer, though there is no tax on the inter State movement, the input tax credit will be restricted to the tax paid on inputs in excess of 4%.

VAT and Logistics Industry

137. Please let me know how VAT will affect Logistics, Warehousing & Transportation industry in India?

Under VAT, businesses need to reorient their distribution policies and this will naturally impact logistics and warehousing industry.

Many businesses have created buffer warehouses in different locations to take advantage of the varying tax rates and to avoid cascading of taxes.

As at present many companies might have found stock transferring goods to its depots or consignment agents advantageous. Under VAT it may be advantageous to effect direct Inter state sale. The impact cannot be generalised. Though there may be certain common factors relevant to all trade and Industry, the impact of VAT needs to be analysed specific to the business model of the individual business. Businesses will have to reorient their procurement and distribution policies. To that extent VAT will impact logistics and warehousing industry.

It may be reteyant for logistics and warehousing companies to have a thorough understanding of the VAT law to be able to assist their clients in planning logistics in the VAT scenario.