VALUE ADDED TAX ~ I

1. INTRODUCTION

A really progressive and welfare oriented country should balance the requirements of direct and indirect taxes in a fair manner. Too much dependence on direct taxes will be exploitive but at the same time passing heavy burdens to the general public by way of indirect taxes will constitute hardships to the common citizen.

Therefore, economic administrators throughout the world have been constantly engaged in the exercise of lightening the burden of indirect taxes on the ultimate consumers. Suppose, for manufacturing a product A, the manufacturer has to purchase four types of commodities B, C, D and E on which he pays excise duty. When ultimately he sells his manufactured product A on which he has to discharge his liability towards excise, the excise duty leviable on such product will be on a tax base which will include excise duties paid by the manufacturer on products B, C, D and E. Thus, the final excise duty is a duty on duty, which will increase the cost of production as well as the price of the final product.

Suppose, we find a method by which the excise duties paid on commodities B, C, D and E are allowed to be set-off from the final duty liability on product A, it is obvious that the manufacturer will not only be able to avoid payment of duty on duty but the cost of the product will also be reduced leading to a benefit to the consumer. This is the origin of Value added tax (VAT).

In simple words, the tax will be levied and collected at each stage of manufacture only on the value added by the manufacturer represented by the purchase value and the value of the work performed on such purchased commodities. This will not only result in cost reduction but will also ensure equity. What we have talked about is a value added tax on manufacture. In the same way, there can be a value added tax in respect of trading in commodities also.

In other words, the various taxes paid on inputs purchased will be allowed as a credit and will be allowed to be set off against the tax liability on the value of sales of the commodity. Thus, there can be a system of VAT in respect of manufacture and in respect of sales. In the same way, one can think of a system of VAT in dealing with input and output services. When the individual systems of manufacturing, sales and services VAT are ultimately combined to form a grand system of VAT on goods and services, such a VAT system will be applicable throughout the country as a common market.

2. HISTORICAL BACKGROUND

This tax was proposed for the first time by Dr. Wilhelm Von Siemens for Germany in 1919. In 1921, VAT was suggested by Professor Thomas S. Adams for the United States of America. VAT was also recommended by the Shoup Mission for the reconstruction of the Japanese Economy in 1949. However, the tax was not introduced by any country till 1953. France led the way in 1954 by adopting a VAT that covered the industrial sector alone and the tax was limited up to the wholesale level.

VAT has, however, been spreading rapidly since the sixties. The Ivory Coast followed France by adopting VAT in 1960. The tax was introduced by Senegal in 1961 and by Brazil and Denmark in 1967. In 1968, France extended VAT to the retail level while the Federal Republic of Germany introduced it in its tax system.

The Netherlands and Sweden imposed this tax in 1969 while Luxembourg adopted it in 1970, Belgium in 1971, Ireland in 1972, and Italy, the United Kingdom, and Austria in 1973. Of the other members of the European Union, Portugal and Spain introduced VAT in 1986, Greece in 1987, while this tax was adopted by Finland in 1994. Many other European countries have adopted VAT. Similarly, many countries in the North and South America, Africa and Oceania have introduced VAT.

VAT has been spreading in the Asian region as well. The Republic of Vietnam adopted VAT briefly in 1973 (VAT was abolished soon but it was reintroduced in 1999 in Vietnam). South Korea introduced VAT in 1977, China in 1984, Indonesia in 1985, Taiwan in 1986, Philippines in 1988, Japan in 1989, Thailand in 1992, and Singapore in 1994 while Mongolia has been implementing this tax since 1998.

In 1986, India introduced VAT in a different way under the name of Modified Value Added Tax (MODVAT). Unlike the VAT system of other countries, the Indian MODVAT system was designed to cover manufacturing of goods by giving credit of excise duty paid on inputs. The scope of MODVAT has been extended over the years and has since been renamed as Central Value Added Tax (CENVAT), which covers services also.

Pakistan adopted VAT in 1990, Bangladesh in 1991, and Nepal in 1997 while Sri Lanka introduced VAT in 1998.

As VAT is more revenue-productive, it has been spreading all over the world. As on today, about 130 countries have adopted the same.

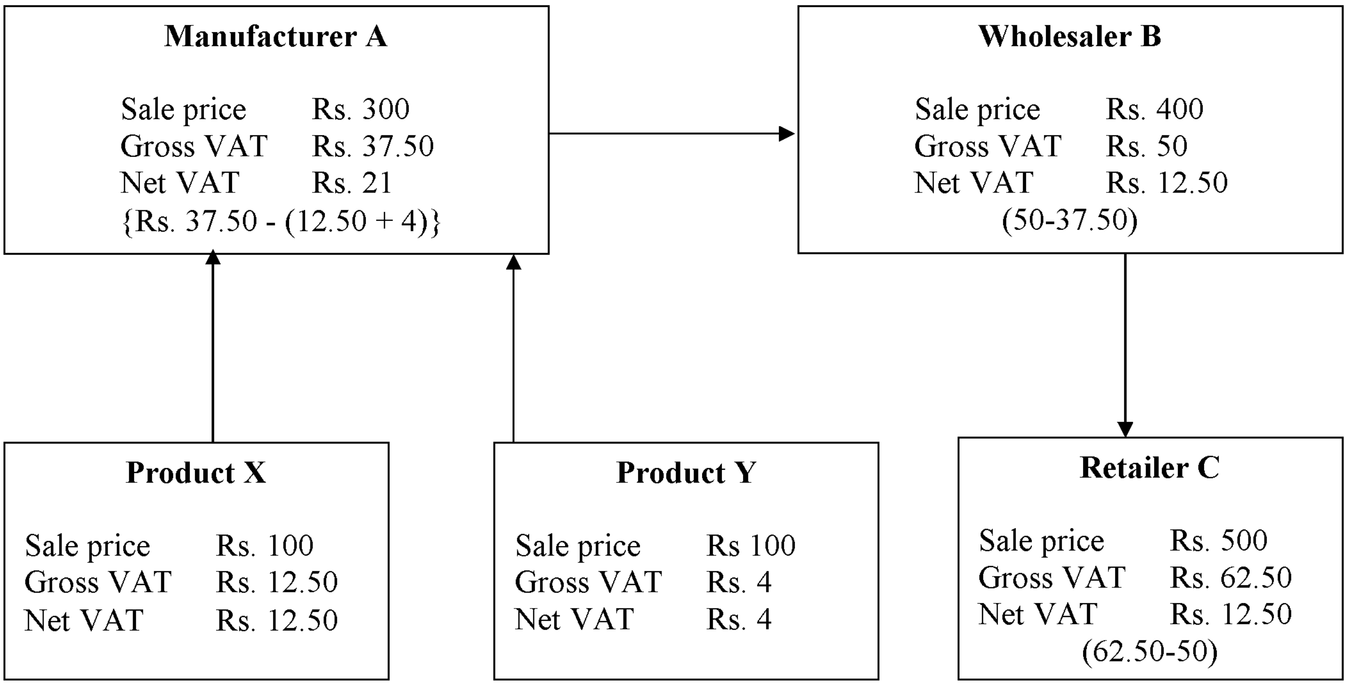
An illustrative list of countries which introduced VAT is given below :

Year of introduction of VAT	Name of country which introduced VAT
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil and Denmark
1968	Federal Republic of Germany
1969	Netherlands & Sweden
1970	Luxembourg
1971	Belgium
1972	Ireland
1973	Italy, U.K. & Austria
1977	South Korea
1984	China
1985	Indonesia
1986	Portugal, Spain, Taiwan, India (introduced MODVAT)
1987	Greece
1988	Philippines
1989	Japan
1990	Pakistan
1991	Bangladesh
1992	Thailand
1994	Finland & Singapore
1997	Nepal
1998	Mongolia & Srilanka
1999	Vietnam

3. TAXONOMY OF VAT

a) Different stages of VAT

The Value Added Tax (VAT) is a multistage tax levied as a proportion of the value added (i.e. sales minus purchase) which is equivalent to wages plus interest, other costs and profits. To illustrate, a chart of transactions is given below :



Input for manufacturer

Note : The rate of tax is assumed to be 12.5% on the transactions relating to goods manufactured by A.

For a manufacturer A, inputs are product X and product Y which are purchased from a primary producer. In practice, even these producers use inputs. For example, a farmer would use seeds, feeds, fertilizer, pesticides, etc. However, for this example their VAT impact is not considered. B is a wholesaler and C is a retailer.

The inputs X and Y are purchased at Rs. 100 each on which tax is paid @ 12.5% and 4% respectively. The manufacturer A would, therefore, take the credit for tax paid by him for the use of such inputs. The input price of Rs. 200 plus tax would include wages, salaries and other manufacturing expenses. To all this, he would also add his own profit. Assuming that after the addition of all these costs his sale price is Rs. 300, the gross tax (at the rate of 12.5 per cent) would be Rs. 37.50. As manufacturer A has already paid tax on Rs. 200, he would get credit for this tax (i.e. 12.50 + 4 = 16.50). Therefore, his net VAT liability would be Rs. 37.50 minus Rs. 16.50. Thus, manufacturer A would pay Rs. 21 only (because of this he would take the cost of his inputs to be only Rs. 200).

Similarly, the sale price of Rs. 400 fixed by wholesaler B would have net VAT liability of Rs. 12.50 (Rs. 50 - 37.50 = Rs. 12.50) and the sales price of Rs. 500 by Retailer C would also have net VAT liability of Rs. 12.50 (Rs. 62.50 - 50 = Rs. 12.50).

Thus, VAT is collected at each stage of production and distribution process, and in principle, its entire burden falls on the final consumer, who does not get any tax credit. Thus, VAT is a broad-based tax covering the value added to each commodity by parties during the various stages of production and distribution.

b) How VAT operates?

The operation of VAT can be further appreciated from the following illustrations :

Illustration :

A is a trader selling raw materials to a manufacturer of finished products. He imports his stock-in-trade as well as purchases the same in the local markets. If the rate of VAT is assumed to be 12.50 % ad valorem, he will pay VAT as under :

		Rs.
a)	A's cost of imported materials (from other State)	10,000
	(A will deposit Rs. 1,250 duty on the above. Since, this is not a State VAT it will form a cost of input)	1,250
b)	A's cost of local materials (VAT charged by local suppliers **Rs. 2,500**. Since the credit of this would be available it will not be included in cost of input)	20,000
c)	Other expenditure (such as for storage, transport, interest, etc.) incurred and profit earned by A	8,750
d)	Sales price of goods	40,000
e)	VAT on the above @ 12.50% (Approx.)	5,000
f)	Invoice value charged by A to the manufacturer, B	45,000

I. A's liability for VAT :

		Rs.
Tax on sales price		5,000
Less : Set-off of VAT paid on purchases :		
On imported goods	Nil	
On local goods	2,500	2,500
Net tax payable		**2,500**

In the above illustration (as well as in illustrations that follows) it is assumed that set off of VAT paid on imported goods from outside countries or other States is not allowed :

Now, B manufactures finished products from the raw materials purchased from A and other materials purchased from other suppliers. His liability would be as under :

	Rs.
B's cost of raw materials (VAT recovered by A Rs. 5,000)	40,000
B's cost of other materials :	
Local purchases (VAT charged on the above **Rs. 2,500**)	20,000
Inter-State Purchases* (CST paid Rs. 400)	10,400
Manufacturing and other expenses incurred and profit earned by B	29,600
Sale price of finished product	1,00,000
VAT on the above @ 12.5%	12,500
Invoice value charged by B to the wholesaler, C	1,12,500

*Credit/set-off for tax paid on inter-State purchases (inputs) is not allowed.

II. B's liability for VAT :

		Rs.
Tax on sales price		12,500
Less : Set-off of VAT paid on purchases :		
To A	5,000	
To other suppliers	2,500	7,500
Net tax payable		**5,000**

When C, after repacking the goods into other packing, sells the finished product to a retailer. The following would be the position :

	Rs.
C's cost of goods (VAT recovered by B Rs. 12,500)	1,00,000
Cost of packing material (VAT charged on the above **Rs. 250**)	2,000
Expenses incurred and profit earned by C	18,000
Sale price of goods	1,20,000
VAT on above @ 12.5%	15,000
Invoice value charged by C to D, a retailer	1,35,000

III. C's liability for VAT :

		Rs.
Tax on sales price		15,000
Less : Set-off of VAT paid on purchases :		
To B	12,500	
To other suppliers	250	12,750
Net tax payable		**2,250**

When D sells the goods to the consumers, the position would be as under :

	Rs.
D's cost of goods (VAT recovered by C Rs. 15000)	1,20,000
Expenses incurred and profit earned by D	20,000
Sale price of goods	1,40,000
VAT on above @ 12.5%	17,500
Invoice value charged by D to the consumers	1,57,500

IV. D's liability for VAT :

	Rs.
Tax on sales price	17,500
Less : Set-off of VAT paid to C	15,000
Net tax payable	**2,500**

Total recovery :

It would be seen that in the above illustrations, at the successive stages at which the raw materials and other goods pass till they are sold to the ultimate consumers, VAT would be collected as under :

	Rs
Paid by suppliers selling raw materials to A	2,500
Net tax paid by A on his sales to B	2,500
Paid by suppliers selling other materials to B	2,500
Net tax paid by B	5,000
Paid by suppliers selling packing materials to C	250
Net tax paid by C	2,250
Net tax paid by D	2,500
Total recovery of Revenue	**17,500**

Now, if tax was leviable under a sales tax law at the last stage in a series of successive sales (when the finished product is sold to consumers) the authorities in the above case would have recovered the entire tax of Rs. 17,500 from D at 12.50 percent on his sale price of Rs. 1,40,000 and all earlier stages are to be exempted.

4. VARIANTS OF VAT

VAT has three variants, viz., (a) gross product variant, (b) income variant, and (c) consumption variant. These variants are presented in a schematic diagram given below :

Different Variants of VAT

Gross product variant	**Income variant**	**Consumption variant**
Tax is levied on all sales and deduction for tax paid on inputs ***excluding*** capital inputs is allowed.	Tax is levied on all sales and deduction for tax paid on inputs and ***depreciation*** on capital inputs is allowed	Tax is levied on all sales and deduction for tax paid on inputs ***including*** capital inputs is allowed.

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

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

Consumption variant of VAT allows for deduction on all business purchases including capital assets. Thus, gross investment is deductible in calculating value added. It neither distinguishes between capital and current expenditures nor specifies the life of assets or depreciation allowances for different assets.

This form is neutral between the methods of production; there will be no effect on tax liability due to the method of production (i.e. substituting capital for labour or vice versa).

Among the three variants of VAT, the consumption variant is widely used. Several countries of Europe and other continents have adopted this variant. The reasons for preference of this variant are :

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

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

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

5. METHODS FOR COMPUTATION OF VAT

There are several methods to calculate the 'value added' to the goods for levy of tax. The three commonly used methods are :

a) Addition Method,

b) Invoice Method and

c) Subtraction Method.

The subtraction method can be further divided into :

a) Direct Subtraction Method

b) Intermediate Subtraction Method

Methods for computation of VAT

- Addition method
  - Aggregating all the factor payments and profits
- Invoice method
  - Deducting tax on inputs from tax on sales
- Subtraction method
  - Direct Subtraction Method
    - Deducting aggregate value of purchase exclusive of tax from the aggregate value of sales exclusive of tax
  - Intermediate Subtraction Method
    - Deducting tax inclusive of purchases from the sales and taxing difference between them

a) <u>Addition Method</u> :

This method aggregates all the factor payments including profits to arrive at the total value addition on which the rate is applied to calculate the tax. This type of calculation is mainly used with income variant of VAT. A drawback of this method is that it does not facilitate matching of invoices for detecting evasion.

Invoice Method :

This is the most common and popular method for computing the tax liability under 'VAT' system. Under this method, tax is imposed at each stage of sales on the entire sale value and the tax paid at the earlier stage is allowed as set-off. In other words, out of tax so calculated, tax paid at the earlier stage i.e., at the stage of purchases is set-off, and at every stage the differential tax is being paid. The most important aspect of this method is that at each stage, tax is to be charged separately in the invoice.

This method is very popular in western countries. In India also, under Central Excise Law this method is followed. ***This method is also called the 'Tax Credit Method' or 'Voucher Method'***. From the following illustration, the mode of calculation of tax under this method will become clear :

Particulars	VAT Liability	Less VAT Credit	Tax to the Government
Manufacturer/first seller in the State sells the goods to distributor for Rs. 1,000. Rate of tax is 12.50%. Therefore, his tax liability will be Rs. 125. He will not get any VAT credit, being the first seller.	125.00	-	125.00
Distributor sells the goods to a wholesale dealer for say Rs. 1,200 @ 12.50% and will get set-off of tax paid at earlier stage at Rs. 125. His tax liability will be Rs. 25	150.00	125.00	25.00
Wholesale dealer sells the goods to a retailer at say Rs. 1,500. Here again he will have to pay the tax on Rs. 1,500. He will get credit of tax paid at earlier stage of Rs. 150. His tax liability will be Rs. 37.50.	187.50	150.00	37.50
Retailer sells the goods to the consumers at say Rs. 2,000. Here again he will have to pay tax on Rs. 2,000. He will get credit for tax paid earlier at Rs. 187.50. His tax liability will be Rs. 62.50.	250.00	187.50	62.50
Total	**712.50**	**462.50**	**250.00**

Thus, the Government will get tax on the final retail sale price of Rs. 2,000. However, the tax will be paid in instalments at different stages. At each stage, tax liability is worked out on the sale price and credit is also given on the basis of tax charged in the purchase invoice. If the first seller is a manufacturer, he gets the credit of tax paid on raw materials, etc. which are used in the manufacturing. From the above illustration, it is clear that under this method, tax credit cannot be claimed unless and until the purchase invoice is produced. As a result, in a chain, if at any stage the transaction is kept out of the books, still there is no loss of revenue. The department will be in a position to recover the full tax at the next stage. Thus, the possibility of tax evasion, if not entirely ruled out, will be reduced to a minimum. However, proper measures should be implemented to prevent the production of fake invoices to claim the credit of tax at an earlier stage.

It is said that in this method the beneficiary is the trade and industry because in the above example, the total tax collection at all the stages is Rs.712.50 whereas tax received by the State is only Rs. 250.

Subtraction Method :

While the above-stated invoice (or tax-credit or voucher) method is the most common method of VAT, another method to determine the liability of a taxable person is the cost subtraction method, which is also a simple method. Under this method, the tax is charged only on the value added at each stage of the sale of goods. Since, the total value of goods sold is not taken into account, the question of grant of claim for set-off or tax credit does not arise. This method is normally applied where the tax is not charged separately. Under this method for imposing tax, 'value added' is simply taken as the difference between sales and purchases.

The following illustration will make the working of this system clear :

Stage No.	Particulars	Turnover for tax under VAT (Rs.)	Tax @ 12.50% (Rs.)
1.	First seller sells the goods to a distributor at say, Rs. 1,125 inclusive of tax	1125	125 $\left(\frac{1125 \times 12.50}{100 + 12.50}\right)$
2.	Distributor sells the goods to a whole-seller at say, Rs. 1,350. Here taxable turnover will be Rs. 1,350 - Rs. 1,125	225	25 $\left(\frac{225 \times 12.50}{100 + 12.50}\right)$
3.	Whole-seller sells the goods to a retailer at say, Rs. 1,687.50. Here taxable turnover will be Rs. 1,687.50 – Rs. 1,350	337.50	37.50 $\left(\frac{337.50 \times 12.50}{100 + 12.50}\right)$
4.	Retailer selling the goods at say, Rs. 2,250. Taxable turnover will be Rs. 2,250 - Rs. 1,687.50	562.50	62.50 $\left(\frac{562.50 \times 12.50}{100 + 12.50}\right)$
	Total	**2250**	**250**

Tax is calculated by the formula : $\frac{T \text{ X } R}{100 + R}$

Here, T = Taxable turnover, R = Rate of Tax

Thus, under this system also, the incidence of tax is at each stage and the incidence of tax on the final sale price to the consumer will remain the same as in the earlier method.

6. COMPARATIVE ANALYSIS OF THREE METHODS OF COMPUTING VAT

A. WHEN RATE OF TAX IS UNIFORM

Methods	Manufacturer	Wholesaler	Retailer	Total Economy
Addition Method :				
(a) Wages	150	300	200	650
(b) Rent	50	100	20	170
(c) Interest	25	75	20	120
(d) Profit	25	25	10	60
(e) Value added [(a)+(b)+(c)+(d)]	250	500	250	1,000
(f) VAT (@ 12.5%)	**31.25**	**62.50**	**31.25**	**125**
Subtraction Method :				
(a) Sales	350	850	1,100	2,300
(b) Purchases	100	350	850	1,300
(c) Value added [(a) – (b)]	250	500	250	1,000
(d) VAT (@ 12.5%)	**31.25**	**62.50**	**31.25**	**125**
Invoice Method :				
(a) Sales	350	850	1,100	2,300
(b) Tax on sales	43.75	106.25	137.5	287.5
(c) Purchases	100	350	850	1,300
(d) Tax on purchases	12.5	43.75	106.25	162.50
(e) VAT [(b) – (d)]	**31.25**	**62.50**	**31.25**	**125**

B. WHEN RATE OF TAX IS NOT UNIFORM

Although all the methods are identical, these are not likely to yield the same revenue when tax rate vary according to commodities (i.e. the rates are different for inputs and that for outputs). As shown in the table given below, the yield would be Rs. 25 under the subtraction method while it is Rs. 20 only under the invoice method when the tax rate is 15% at wholesale stage and 10% at other stages.

Methods	Manufacturer	Wholesaler	Retailer	Total Economy
(a) Sales	100	200	250	550
(b) Purchases	50	100	200	350
(c) Value added [(a) – (b)]	50	100	50	200
Rate of VAT is 10% on all stages :				
VAT under Subtraction Method [10% of (c)]	5	10	5	20
VAT under Invoice Method [10% of (a) – 10% of (b)]	10-5 = 5	20-10 = 10	25-20 = 5	55-35 = 20
Rate of VAT is 15% at wholeselling level and 10% at all other stages :				
VAT under Subtraction Method [15% of (c) in the hands of the wholesaler and 10% of (c) at other stages]	5	15	5	25
VAT under Invoice Method	10-5 = 5	30-10 = 20	25-30 = (5)	65-45 = 20

7. MERITS AND DEMERITS OF VAT

A. MERITS OF VAT

a) **No tax evasion :** It is said that VAT is a logical beauty. Under VAT, credit of duty paid is allowed against the liability on the final product manufactured or sold. Therefore, unless proper records are kept in respect of various inputs, it is not possible to claim credit. Hence, suppression of purchases or production will be difficult because it will lead to loss of revenue. A perfect system of VAT will be a perfect chain where tax evasion is difficult.

b) **Neutrality :** The greatest advantage of the system is that it does not interfere in the choice of decision for purchases. This is because the system has anti-cascading effect. How much value is added and at what stage it is added in the system of production/distribution is of no consequence. The system is neutral with regard to choice of production technique, as well as business organization. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase. VAT facilitates precise identification and rebate of the tax on purchases and thus ensures that there is no cascading effect of tax.

c) **Certainty :** The VAT is a system based simply on transactions. Thus there is no need to go through complicated definitions like sales, sales price, turnover of purchases and turnover of sales. The tax is also broad-based and applicable to all sales in business leaving little room for different interpretations. Thus, this system brings certainty to a great extent.

d) **Transparency :** Under a VAT system, the buyer knows, out of the total consideration paid for purchase of material, what is tax component. Thus, the system ensures transparency also. This transparency enables the State Governments to know as to what is the exact amount of tax coming at each stage. Thus, it is a great aid to the Government while taking decisions with regard to rate of tax etc.

e) **Better revenue collection and stability :** The Government will receive its due tax on the final consumer/retail sale price. There will be a minimum possibility of revenue leakage, since the tax credit will be given only if the proof of tax paid at an earlier stage is produced. This means that if the tax is evaded at one stage, full tax will be recoverable from the person at the subsequent stage or from a person unable to produce proof of such tax payment. Thus, in particular, an invoice of VAT will be self enforcing and will induce business to demand invoices from the suppliers. Another attribute of VAT is that it is an exceptionally stable and flexible source of government revenue.

f) **Better accounting systems :** Since the tax paid on an earlier stage is to be received back, the system will promote better accounting systems.

g) **Effect on retail price :** A persistent criticism of the VAT form has been that since the tax is payable on the final sale price, the VAT usually increases the prices of the goods. However, VAT does not have any inflationary impact as it merely replaces the existing equal sales tax. It may also be pointed out that with the introduction of VAT, the tax impact on raw material is to be totally eliminated. Therefore, there may not be any increase in the prices.

B. DEMERITS OF VAT

a) The merits accrue in full measure only under a situation where there is only one rate of VAT and VAT applies to all commodities without any question of exemptions whatsoever. Once concessions like differential rates of VAT, composition schemes, exemption schemes, exempted category of goods etc. are built into the system, distortions are bound to occur and the fundamental principle that VAT will totally eliminate cascading effects of taxes will also be subject to qualifications.

b) In the federal structure of India in the context of sales-tax, so long as Central VAT is not integrated with the State VAT, it will be difficult to put the purchases from other States at par with the State purchases. Therefore, the advantage of neutrality will be confined only for purchases within the State.

c) For complying with the VAT provisions, the accounting cost will increase. The burden of this increase may not be commensurate with the benefit to traders and small firms.

d) Another possible weak point in the introduction of VAT, which will have an adverse impact on it is that, since the tax is to be imposed or paid at various stages and not on last stage, it would increase the working capital requirements and the interest burden on the same. In this way it is considered to be non-beneficial as compared to the single stage-last point taxation system.

e) VAT is a form of consumption tax. Since, the proportion of income spent on consumption is larger for the poor than for the rich, VAT tends to be regressive. However, this weakness is inherent in all the forms of consumption tax. While it may be possible to moderate the distribution impact of VAT by taxing necessities at a lower rate, it is always advisable to moderate the distribution considerations through other programmes rather than concessions or exemptions, which create complications for administration.

f) As a result of introduction of VAT, the administration cost to the State can increase as the number of dealers to be administered will go up significantly.

8. VAT IN INDIAN CONTEXT

The Indian Union is a federal structure under the Constitution of India. The Central Government and the State Governments derive their powers through the instrumentality of the Union List, the State List and the Concurrent List. So far as powers of taxation are concerned there are clearly specified areas over which the Central Government and the States can exercise their jurisdiction.

While Income-tax, excise duty and customs duty constitute the major sources of tax revenue to the Central Government, the State Governments substantially depend on sales tax as the main source of revenue. The Central Government undertook a series of reforms in indirect taxes, the major among which was the introduction of Modified VAT, which is currently in operation as CENVAT. However, in view of the constitutional constraints, CENVAT applies to goods and services but not to sales tax and State-Level VAT.

Central Value Added Tax (CENVAT) :

At the Central level, at the time of Independence, India inherited a system of commodity taxes in which excise duties were levied on about a dozen articles yielding a small proportion of total tax revenue to the Centre. Following Independence, the rates were raised, the base was enlarged, and more and more items were brought into its net. Over time, there was a speedy extension of excise duties. It was not only levied on finished goods but also covered raw materials, intermediate goods and capital goods.

Structure of CENVAT :

As of now, the Central Government levies excise duties on all goods manufactured or produced in the country. Such duty is paid by the manufacturer / producer at the time of removal of goods from the factory at prescribed rates.

The prevailing structure of such duties includes (i) CENVAT, (ii) special excise duty (SED), (iii) additional excise duty on goods of special importance, AED (GSI) (iv) additional duty of excise on textiles and textile articles, AED (T&TA), and (v) cesses on specified commodities.

With effect from March 1, 1986, MODVAT was introduced under the union excise duty as a system of giving credit for excise duty on inputs. Initially, it was introduced for a selected number of commodities. Over time, MODVAT was extended and was finally replaced by Central VAT, known as CENVAT in the Budget 2000-01. CENVAT has in general a single rate of 16% with some variations for select commodities.

The CENVAT scheme initially allowed instant credit for specified excise duties paid on inputs and capital goods received in a factory for the manufacture of any dutiable final products. The credit could be utilized to pay excise duty on any final product.

The Finance Act, 2004 marked a beginning for an integrated goods and service tax system wherein the duties of excise paid on inputs / capital goods and service tax paid on input services could be adjusted against a manufacturer's excise duty liability or a service provider's service tax liability. At present, the CENVAT scheme is governed by CENVAT Credit Rules, 2004.

Committee of State Finance Ministers :

After the introduction of VAT in the area of manufacture and services, a need for uniformity arose wherein similar system was proposed to be incorporated in the area of sales thereby replacing the existing sales tax system. To materialize this concept, the then Union Finance Minister called a meeting of the State Finance Ministers in May 1994 and a Committee of State Finance Ministers was constituted on sales tax reform following this meeting. The Committee had to examine all aspects of sales tax reform, including the introduction of VAT.

The Committee recommended several measures to rationalize the existing sales tax with the ultimate aim of introducing VAT at the State level. The major recommendations included simplification of the rate structure, minimization of the exemptions and enhancement of transparency. To this end, the Committee recommended :

1. The adoption of four general floor rates (0, 4, 8, 12) and two special floor rates (1 and 20) in place of the existing multiple rates being levied in different States;
2. Keeping the exemptions to a minimum;
3. Preparing a list of exempt goods and fixing a target date beyond which no State/Union Territory should exempt goods other than those mentioned in the list, and;
4. Doing away with sales tax incentives for industrialization. No new tax incentives should be given after 1 April, 1997, and the existing ones should be allowed to lapse in due course.

The Committee also recommended several preparatory steps to be taken for the implementation of a full-fledged State-Level VAT. This included a massive taxpayers' education programme, computerization of sales tax administration, and preparation of model VAT legislation. For implementing the above decisions, an Empowered Committee of State Finance Ministers was set up.

White Paper on State-Level VAT in India :

The Empowered Committee of State Finance Ministers met regularly and with the repetitive discussions and collective efforts brought out a White paper on 17.01.2005, which provided a base for the preparation of various State VAT legislations. It has been recognized that VAT is a State subject and therefore, the States will have freedom for appropriate variations consistent with the basic design as agreed upon at the Empowered Committee. Broadly, the White Paper consists of the following :

(a) Justification of VAT and Background

(b) Design of State-Level VAT.

(c) Steps taken by the States.

9. PRESENT POSITION

Finally State-Level VAT was introduced on 01.04.2005 by majority of the States. The States have passed State-Level VAT legislations, which are modeled on the draft model VAT law, prescribed by the Central Government. The legislations also incorporate the various principles of State-Level VAT as contained in the White Paper released by the Empowered Committee. However, such State Legislations contain provisions to cater to the specific needs of the State finances.

Discontinuance of the Central sales tax : With the introduction of State-Level VAT system, it is proposed to phase out the Central sales tax (CST). However, since the states will stand to lose large revenue on account of its discontinuance a mechanism is being thought of for compensating the States for such loss of revenue.

10. AUDIT PROVISIONS UNDER VAT

Like majority of the developing economies our country is also facing the problem of lack of education and awareness about tax laws, more particularly amongst the trading community. Further, the VAT system of taxation is new to them. Since the trading community is not educated enough and equipped to understand the implications of the VAT system of taxation immediately, there is every possibility that they may not be in a position to arrange their business affairs to fall in line with the requirements of the State-Level VAT and calculate and discharge their exact tax liability under the VAT laws. On the other hand, the tax administrator i.e. the authorities in the taxation department also find themselves devoid of sufficient resources to educate the tax payers and inform them about the procedural and accounting changes that are necessitated by the implementation of VAT system.

Further, under the VAT system a major thrust is to be laid on the 'self assessment' i.e., the tax liability, calculated and paid by the tax payers through their periodical returns, will be accepted by and large and the tax payers will not be called to substantiate the tax liability shown by them in the returns by producing books of account and other relevant material. The assessments with books of account will be an exception.

Therefore, there is a strong need to see that the taxpayers discharge their tax liability properly while filing the returns. This can be ensured only when the particulars furnished by the tax payers are verified by an independent auditor in minute details by :

- going through the books of account and
- analysing and interpret the provisions of the State-Level VAT laws and
- reporting the under-assessment, if any, made by the dealer requiring additional payment or
- reporting any excess payment of tax warranting refund to the tax payer.

In most of the countries tax evasion is rampant under the existing tax systems. In India too, evasion of excise and sales-tax is estimated to be very high. If no audit is prescribed under VAT law, the chances of evasion of VAT tax will increase causing revenue leakage for the Government. It is, therefore, essential that the audit of the proposed VAT system is attempted on a regular basis. However, it is not possible to conduct the audit of all the VAT dealers.

Therefore, the criteria for audit can be the amount of turnover or the class of dealer dealing in specified commodities.

The concept of audit is popular even in foreign countries where the system of VAT is in practice since long in the field of indirect taxation. In countries like France and Korea the audit has proved to be an effective tool to check the evasion of tax, which was mostly done by producing fake invoices etc.

Since VAT is a new concept, some of the States want to keep the procedural formalities to the minimum. Hence, at the initial stage their law makers refrain from keeping any audit provisions in their Act and rules. Perhaps, this may be due to the initial stage of introduction of VAT. But most of the States, keeping in mind the importance of audit, have incorporated the audit provisions since inception. Some States like the State of Maharashtra and State of Kerala have provided detailed particulars to be furnished by various dealers in respect of their VAT assessments.

11. ICAI'S ROLE IN VAT

The ICAI has rendered pioneering service in evolving the necessary accounting guidelines both for CENVAT as well as State Level VAT. It has brought out Guidance Notes for accounting for CENVAT as well as State-Level VAT. These Guidance Notes address all the accounting issues in regard to CENVAT and State-Level VAT. Further, the Institute has brought out a comprehensive study on State-Level VAT in India. It contains an elaborate discussion of the various general principles of VAT and State Level VAT. These general principles have been incorporated in the various State-Level VAT legislations. However, there are special provisions contained in the respective State level legislations to cater to the specific needs of the States. Various State governments have issued detailed clarification on different practical issues arising on implementation of the State-Level VAT.

12. ROLE OF CHARTERED ACCOUNTANTS IN VAT

Chartered Accountants have a key role to play in implementation of VAT.

a) **Record keeping :** VAT requires proper record keeping and accounting. Systematic record of input credit and its proper utilization is necessary for the success of VAT. Chartered Accountants are well equipped to perform such tasks.

b) **Tax planning :** In order to establish an efficient plan for purchases and sales, a careful study of VAT is required. A Chartered Accountant is competent to analyze the impact of various alternatives and choose the most optimum method of purchases and sales in order to minimize the tax impact.

c) **Negotiations with suppliers to reduce price :** VAT credit alters cost structure of goods supplied as inputs. A Chartered Accountant will ensure that the benefit of such cost reduction is passed on by the suppliers to his company. However, if the buyers of his company make the similar demand, he must be ready with full data to resist the claims.

d) **Handling the audit by departmental officers :** There will be audit wing in department and certain percentage of dealers will be taken up for audit every year on scientific basis. Chartered Accountant can ensure proper record keeping so as to satisfy the departmental auditors. The professional expertise of a Chartered Accountant will help him in effectively replying audit queries and sorting out audit objections.

e) **External audit of VAT records :** Under VAT system, trust has been reposed on tax payers as there will be no regular assessment of all VAT returns but only few returns will be scrutinized. In other cases, return filled by dealer will be accepted. Thus, a check on compliance becomes necessary. Chartered Accountants can play a very vital role in ensuring tax compliance by audit of VAT accounts.

VAT laws of some States provide for audit by outside agencies. In Karnataka, audit report is required if turnover exceeds Rs. 25 lakhs. Andhra Pradesh VAT Act provides for audit by Chartered Accountant, if audit is ordered by Commissioner. Maharashtra VAT laws provide for audit by Chartered Accountants, if turnover exceeds Rs.40 lakhs. Other States may also prescribe external audit, once they see the utility of reports furnished by Chartered Accountant in ensuring tax compliance.

13. GOODS AND SERVICE TAX

The ultimate system of indirect taxes in India will be a goods and service tax. Under such a system there will be one central authority administering a uniform goods and service tax. Input tax credit will be available between goods and services throughout the country. However, such a development will require constitutional amendment. Under such a uniform tax system, there will be no trade barriers like octroi and entry tax. There will be a free flow of trade and commerce through out the length and breadth of the country. India will then become a vast common market. The Union Finance Minister in his Budget speech for the year 2006-07 has announced 1st April, 2010 as the target date to introduce GST.

VALUE ADDED TAX ~ I

Self-examination questions

1. Value added tax is levied at :

   a) first stage of sale

   b) multistage

   c) last stage of sale

   d) none of the above

2. A trader purchases raw material from the local market worth Rs. 20,000 and pays VAT @ 12.50% i.e. Rs. 2,500. He also imports the material worth Rs. 10,000 on which he pays the duty of Rs. 1,250. He can avail the input credit of :

   a) Rs. 1,250/-

   b) Rs. 2,500/-

   c) Rs. 3,750/

   d) None of the above.

3. Which was the first country to introduce VAT?

   a) France

   b) Brazil

   c) Senegal

   d) Denmark

4. CENVAT is applicable in respect of :

   a) excise duties

   b) custom duties

   c) service tax

   d) excise duty and service tax

5. The method for computation of tax in which all the factor payments including profits are aggregated to arrive at the total value addition on which the rate is applied to calculate the tax is :

   a) Invoice method

   b) Subtraction method

   c) Addition method

   d) Direct subtraction method

6. In India, the State-Level VAT has replaced :

   a) the excise duty

   b) the State-sales tax

   c) the import duty

   d) none of the above

7. Which variant/variants is/are widely used among the three variants of VAT?

a) Consumption variant

b) Gross product variant

c) Income variant

d) Consumption and income variant

8. Which of the following statements are true? Give proper explanation for your answer.

a) CENVAT is paid on the value of goods purchased in India.

b) A trader can take credit of the inputs purchased by him only if he has obtained proper tax invoice from the vendor.

c) VAT is inflationary in nature.

d) White Paper on State Level VAT provides a framework for drafting various State VAT Legislations.

Answers

1. (b)

2. (b)

3. (a)

4. (d)

5. (c)

6. (b)

7. (a)

8. (b) & (d)

VALUE ADDED TAX ~ II

Input tax credit and composition scheme for small dealers

1. CONCEPTS OF INPUT TAX AND OUTPUT TAX

Input tax is the tax paid or payable in the course of business on purchases of any goods made from a registered dealer of the State. Output tax means the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business.

In simple words input tax is the tax a dealer pays on his local purchases of business inputs, which include the goods that he purchases for resale, raw materials, capital goods as well as other inputs for use directly or indirectly in his business. Output tax is the tax that a dealer charges on his sales that are subject to tax.

2. INPUT TAX CREDIT (ITC)

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax.

It is reiterated that tax paid on the earlier point is called input tax. This amount will be adjusted/rebated against the tax payable by the purchasing dealer on his sales. This credit availability is called input tax credit; it can also be referred to as tax credit on a sale within the State.

a) Scope of input tax credit

Input tax credit shall be allowed to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Further, the input tax credit will be given to both manufacturers and traders for purchase of inputs/supplies meant for both sale within the State as well as to other States, irrespective of when these will be utilized/sold.

Even for stock transfer/consignment transfers/branch transfer of goods out of the State, input tax paid in excess of 4% will be eligible for tax credit. It is also to be noted that in some States partial input tax credit is available in respect of inputs used for manufacture of exempted goods.

b) Input tax credit available on capital goods

Input tax credit on capital goods will also be available for traders and manufacturers. Tax credit on capital goods may be adjusted over a maximum of 36 equal monthly instalments. The States may at their option reduce this number of instalments. The State of Maharashtra has decided to give full input tax credit in the month of purchases only. However, if the capital asset is sold within the period of 36 months proportionate input credit will be withdrawn. There is a negative list for capital goods (on the basis of principles already decided by the Empowered Committee) not eligible for input tax credit.

3. VAT LIABILITY

The Value Added Tax (VAT) is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period (say, a month).

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

(a) Input purchased within the month : Rs. 1,00,000/-

(b) Output sold in the month : Rs. 2,00,000/-

(c) Input tax paid : Rs. 4,000/-

(d) Output tax payable : Rs. 25,000/-

(e) VAT payable during the month after set-off of input tax credit [(d) – (c)] : Rs. 21,000/-

Following example illustrates how excess VAT credit can be availed :

(A)	Tax paid on purchases made in the State within a month (i.e. input tax)	Rs. 10,000
(B)	Tax charged for sales in the State within a month (i.e. output tax)	Rs. 4,500
(C)	CST charged for inter-State sales within a month	Rs. 15,000
(D)	Input tax credit	Rs. 10,000
(E)	VAT liability [(B) – (D) i.e. Rs. 4,500 – Rs. 10,000]	Nil
(F)	Excess credit [(D) – (B) i.e. Rs. 10,000 – Rs. 4,500]	5,500
(G)	CST to be paid to the Government [(C) – (F) i.e. Rs. 15,000 – Rs. 5,500]	9,500

In the present case CST to be paid to Government is Rs. 9,500 (CST of Rs. 15,000 will be reduced by excess VAT credit of Rs. 5,500/-)

4. ELIGIBLE PURCHASES FOR AVAILING INPUT TAX CREDIT

For the purpose of claiming input tax credit, the taxable goods should be purchased for any one of the following purposes :

(i) for sale/resale within the State;

(ii) for sale to other parts of India in the course of inter-State trade or commerce;

(iii) to be used as :

a) containers or packing materials;
b) raw materials; or
c) consumable stores,

required for the purpose of manufacture of taxable goods or in the packing of such manufactured goods intended for sale in the State or in the course of inter-State trade or commerce;

(iv) for being used in the execution of a works contract;

(v) to be used as capital goods required for the purpose of manufacture or resale of taxable goods;

(vi) to be used as :

a) capital goods;
b) containers or packing materials;
c) raw materials;
d) consumable stores

for manufacturing/packing goods to be sold in the course of export out of the territory of India;

(vii) for making zero-rated sales other than those referred to in clause (vi) above [i.e. sales to SEZ].

Common goods used for taxable goods and tax-free goods : Provisions have been made in most of the States to provide that the purchases should be used for manufacture etc. of ***taxable goods***. Taxable goods mean goods other than the goods which are specified in the Schedule for tax-free goods. Where the purchased goods are used partially for the purpose specified above, input tax credit shall be allowed proportionate to the extent the purchases are used for the purposes specified above.

5. PURCHASES NOT ELIGIBLE FOR INPUT TAX CREDIT

Input tax credit may not be allowed in the following circumstances :

(i) purchases from unregistered dealers;

(ii) purchases from registered dealer who opt for composition scheme under the provisions of the Act;

(iii) purchase of goods as may be notified by the State Government;

(iv) purchase of goods where the purchase invoice is not available with the claimant or there is evidence that the same has not been issued by the selling registered dealer from whom the goods are purported to have been purchased;

(v) purchase of goods where invoice does not show the amount of tax separately;

(vi) purchase of goods, which are being utilized in the manufacture of, exempted goods;

(vii) goods in stock, which have suffered tax under an earlier Act but under VAT Act they are covered under exempted items;

(viii) purchase of goods used for personal use/consumption or provided free of charge as gifts (partial credit is available in the State of Maharashtra);

(ix) goods imported from outside the territory of India (commonly known as high seas purchases);

(x) goods imported from other States viz. inter-State purchases.

6. CARRYING OVER OF TAX CREDIT

Input tax credit is first to be utilized for payment of VAT. The excess credit can be then adjusted against the Central Sales Tax (CST) for the said period. After the adjustment of VAT and CST, excess credit, if any, will be carried over to the next tax period or next financial year, as the case may be. If there is any excess unadjusted input tax credit at the end of second year, then the same will be eligible for refund in normal course. However, some States have decided to grant refund after the end of the first financial year itself.

Illustration :

(A)	Inputs purchased within a month	Rs. 10,00,000
(B)	Outputs sold in the month	Rs. 7,50,000
(C)	Input tax paid @12.50% on (A)	Rs. 1,25,000
(D)	Tax @12.5% on sale of goods of Rs. 7,50,000/- during the month	Rs. 93,750
(E)	Net VAT payable during the month [(D) - (C)]	Nil
(F)	Tax credit to be carried to the next month [(C) - (D)]	Rs. 31, 250

7. REFUND TO EXPORTERS WITHIN THREE MONTHS

The White Paper provides for the grant of refund of input tax paid if the goods are exported out of the country. Under the basic design of the White Paper this refund is to be granted within a period of 3 months.

8. EXEMPTION OR REFUND TO SEZ AND EOU UNITS

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

9. CONCEPT OF INPUT TAX CREDIT ON CAPITAL GOODS

A dealer has to purchase capital goods, which may include plant and machinery, furniture, fixture, electrical installations, vehicles etc. Similarly, a dealer may be creating capital assets himself by purchasing materials for capital assets like, building materials etc. Normally all the above items are taxable and the dealer has to pay sales-tax on purchase of the above goods. Each State-VAT legislations may define 'capital goods' differently.

Normally, under VAT system the dealer should get full credit for tax paid on such purchases, more particularly when the basic principle is to avoid the cascading effect. These assets are used for the business and while fixing sale price of the business products the dealer has to include some portion towards the cost of the acquisition of these assets as part of the sale price. If the input credit is not allowed in full then certainly, to the extent of disallowance, the principle of VAT gets defeated. For example, a dealer has purchased furniture for his business, costing Rs.1,00,000/-. Assuming that the vendor has charged tax to him @ 12.5%, he will incur an additional cost of Rs.12,500/- by way of VAT. Now, if the credit for VAT paid is allowed, the dealer can consider the cost of acquisition at Rs.1,00,000/-. If the credit of tax paid is not allowed then he has to consider the cost of purchase at Rs.1,12,500/-. While marking up his price on account of establishment cost he has to consider this cost of furniture as one of the components. If cost remains higher, obviously to that extent the mark up will go up. If the cost is lower i.e. after considering input credit of Rs.12,500/- the cost will be lower and to that extent the mark up will also be lower, resulting in an overall lower sale price.

When tax paid on purchases is included in cost, the said tax indirectly gets reflected in the sale price and hence there is also an element of tax upon tax. This cascading effect can very well be imagined from the above example. Depending upon the volume of capital goods and the tax component on the same the magnitude of the cascading effect can be imagined. When the tax is collected on sales, indirectly there is collection of tax on the cost of capital goods also which includes tax paid on purchase of such assets.

a) Policy in the white paper

The policy lays down that in relation to capital goods set off will be available to traders and manufacturers. The most important factor is that the White Paper recognizes the fact that set off is to be given to both traders and manufacturers. It is well known that under traditional sales-tax system, in some States, partial credit was allowed on capital goods to the manufacturers but no credit was allowed to traders. The White Paper, taking into account the very basis of VAT system, laid down a policy statement that set off will be allowed to both manufacturers and traders.

However as per the White Paper, the State Governments can provide to give set off on a staggering basis, at the most in 36 instalments. This is subject to the policy of individual States. The States, like Maharashtra, have provided set off in one slot and the same is to be claimed immediately on effecting purchase.

b) Restrictions on credit relating to capital goods

It should be noted that credit on capital goods is not being allowed across the floor. As per the White Paper, there will be a negative list for capital goods which will be based on certain pre-agreed principles by the Empowered Committee. The capital goods mentioned in the negative list would not be eligible for input tax credit. However, it appears that the States have taken their own decisions to provide negative lists or reduction in set off in respect of capital goods.

c) Procedural requirements for claim of set off

Barring the items covered by the negative list, the dealers are entitled to set off on capital goods like any other purchases. Thus, the dealer will have to bifurcate their purchase into capital goods eligible for set off and capital goods not so eligible.

In respect of eligible capital goods the dealer will be required to follow the procedural requirements for claiming set off successfully. For example, dealers will be required to support purchase of capital goods with tax invoice. In the absence of such tax invoice set off will be disallowed.

Once a dealer is entitled to set off he has to further comply with the relevant provisions in respect of allowability. If it is subject to certain installments, the dealer will be required to claim set off accordingly in his returns. If the set off is subject to prior permission, the same should be duly obtained.

The allowable set off on capital goods will be, of course, part of normal set off. The dealer will be able to adjust this set off against his other VAT liability. For example, dealer can adjust his set off as per the following illustration :

Particulars	Rs.
(A) VAT paid on procurement of inputs/supplies worth Rs.1 lakh @ 12.50%	12,500
(B) VAT paid on procurement of capital goods of Rs.10 lakhs @ 12.50%	1,25,000
(C) VAT credit available in the month [(A) + (B)]	1,37,500
(D) VAT on sales of Rs.10,00,000 during the month @ 12.50%	1,25,000
(E) VAT payable during the month [(D) – (C)]	Nil
(F) Carry over of tax credit for set off during the next month [(C) - (D)]	12,500

It may be mentioned here that the set off under VAT Acts are subject to one very important condition. It is generally provided in VAT Acts that the set off on any goods should not exceed the tax received on the same goods in Government Treasury. For example, Section 48(5) of the Maharashtra VAT Act provides that a dealer will not be entitled to set off more than the amount received in the Government Treasury. Therefore, if the vendor fails to make the payment of tax to the Government, the purchaser's claim of set off will be denied inspite of the fact that he has paid the tax to his vendor. Therefore, the purchasing dealer, desirous of claiming set off, should also look into the credentials of the vendor so as to be sure that he will get the set off of tax paid to him.

VALUE ADDED TAX ~ II

Self-examination questions

1. Input tax is :

a) the tax charged in the course of business for the sale of any goods made to any dealer of the State.

b) the tax paid in the course of business on purchases of any goods made from any dealer of the State.

c) the tax paid or payable in the course of business on purchases of any goods made from a registered dealer of the State.

d) the tax charged or chargeable in the course of business for the sale of any goods made to a registered dealer of the State.

2. Output tax is :

a) the tax charged or chargeable by a registered dealer for the sale of goods in the course of business.

b) the tax paid or payable by any dealer for the purchase of goods in the course of business.

c) the tax charged or chargeable by any dealer for the sale of goods in the course of business.

d) None of the above

3. Input tax credit in relation to any period means :

a) setting off the amount of input tax by a registered dealer against the amount of his output tax.

b) setting off the amount of output tax by a registered dealer against the amount of his input tax.

c) setting off the amount of input tax by any dealer against the amount of his output tax.

d) All of the above

4. For stock transfer/consignment transfers/branch transfer of goods out of the State, input tax paid in excess of ___________ will be eligible for tax credit.

a) 4%

b) 10%

c) 5%

d) 2%

5. Which of the following purchases is not eligible for input tax credit?

a) Purchases made for sale to other parts of India in the course of inter-State trade or commerce

b) Purchases to be used in the packing of manufactured goods intended for sale in the State or in the course of inter-State trade or commerce

c) Purchases to be used as capital goods required for the purpose of manufacture or resale of taxable goods

d) Purchases from unregistered dealers

6. Which of the following statement is true?

a) Set off of input tax credit on capital goods is available to both traders and manufacturers.

b) Set off of input tax credit on capital goods is available only to manufacturers.

c) Set off of input tax credit on capital goods is available only to traders.

d) None of the above.

<u>Answers</u>

1. (c)

2. (a)

3. (a)

4. (a)

5. (d)

6. (a)

VALUE ADDED TAX ~ III

Composition scheme for small dealers

1. PRINCIPLES LAID DOWN IN THE WHITE PAPER

The relevant provisions provided in the White Paper in relation to composition scheme read as under :

"Small dealers with annual gross turnover not exceeding Rs. 50 lakhs in the last financial year who are otherwise liable to pay VAT, shall however have the option for a composition scheme with payment of tax at a small percentage of gross turnover. The dealers opting for this composition scheme will not be entitled to input tax credit."

2. THRESHOLD EXEMPTION LIMIT

The White Paper, in order to provide relief to the small dealers, specifies that registration for VAT will not be compulsory for dealers below a threshold (Rs. 5 lakhs) turnover, and there will be a provision of an optional and simple composite scheme of taxation of a small percentage of gross turnover.

However, the Empowered Committee of State Finance Ministers subsequently allowed the States to increase the threshold limit for the small dealers to Rs. 10 lakhs with the condition that the concerned State would bear the revenue loss on account of increase in the limit beyond Rs. 5 lakhs.

3. STATE LAWS TO PROVIDE FOR COMPOSITION SCHEME

The VAT Act is so designed that high value taxpayers should not be spared and the small dealers should be free from hassles of compliance procedures. The States have to provide composition scheme for small dealers i.e. the dealer whose total turnover exceeds Rs. 5 lakhs (now 10 lakhs as per the decision of the Empowered Committee of State Finance Ministers) but does not exceed Rs. 50 lakhs. Such a dealer would have an option to pay a composite amount of tax based on its annual gross turnover at the applicable rate subject to such conditions as may be prescribed. However, in such cases a dealer shall not be entitled to input tax credit on inputs and shall not be authorized to issue vatable invoices.

The Empowered Committee has permitted the States to reduce the rate of composition tax to as low as 0.25 %. The composition tax at the rate decided by the State Governments can now be levied on the taxable turnover instead of gross annual turnover.

Besides this, the State Governments may also provide for different types of composition schemes to be notified for different classes of retailers.

4. FEATURES OF COMPOSITION SCHEME

The decision to join composition scheme will be an individual decision. This decision will depend on the fact as to how VAT affects the dealer's business. The advantage of this scheme is that it saves a lot of labour and effort in keeping records. It also simplifies calculation of tax liability of a dealer. Such schemes generally have the following features :

(i) a very small tax will be payable;

(ii) there will be a simple return form to cover longer return period.

The major disadvantage of this scheme is the ineligibility of the dealer to avail input tax credit and issue tax invoices in order to pass on tax credit. Hence, the dealers desirous of availing input tax credit on their purchases may not prefer to buy from composition dealers.

5. ELIGIBILITY FOR THE COMPOSITION SCHEME

Every registered dealer who is liable to pay tax under the respective State VAT Acts and whose turnover does not exceed Rs. 50 lakhs in the last financial year is generally entitled to avail this scheme. However, the following are not eligible for the composition scheme :

(i) a manufacturer or a dealer who sells goods in the course of inter-state trade or commerce; or

(ii) a dealer who sells goods in the course of import into or export out of the territory of India.

(iii) a dealer transferring goods outside the State otherwise than by way of sale or for execution of works contract.

6. EXERCISING OF OPTION

It is generally optional for a dealer to opt for this composition scheme. A dealer who intends to avail such composition scheme shall exercise the option in writing for a year or a part of the year in which he gets himself registered. For this the dealer has to intimate to the Commissioner.

If a dealer avails this scheme, he need not maintain any statutory records as prescribed under the Act. Only the records for purchase, sales, and inventory should be maintained. However, if a dealer does not avail the scheme, he has to maintain the prescribed statutory records as per the respective State VAT Acts.

The dealer should not have any stock of goods which were brought from outside the State on the day he exercises his option to pay tax by way of composition and shall not use any goods brought from outside the State after such date. The dealer should also not claim input tax credit on the inventory available on the date on which he opts for composition scheme.

7. VAT CHAIN UNDER COMPOSITION SCHEME

a) Loss to the seller

If the composition scheme is availed by a dealer then such dealer cannot avail input tax credit in respect of input tax paid. Hence the dealer will be losing the input tax credit on purchases made by him. He will not be able to pass on the benefit of input tax credit, which will add to the cost of the goods.

b) Loss to the purchaser

The purchaser shall not get any tax credit for the purchases made by him from the dealer operating under the composition scheme. Therefore, as soon as a dealer opts for the composition scheme, the VAT chain will be broken, and the benefit of tax paid earlier will not be passed on to the subsequent buyers.

Self-examination questions

1. **As per the White Paper, which of the following dealer may opt for composition scheme?**

   a) **the dealer whose total turnover does not exceed Rs.50 lakhs**

   b) **the dealer whose total turnover exceeds Rs.70 lakhs**

   c) **the dealer whose total turnover exceeds Rs.60 lakhs**

   d) **the dealer whose total turnover exceeds Rs.50 lakhs**

2. **Which of the following statement is false?**

   a) **Under the composition scheme, a dealer cannot avail input tax credit.**

   b) **Under the composition scheme, a dealer cannot issue tax invoice.**

   c) **Under the composition scheme, a dealer can pass on credit by issuing a supplementary invoice.**

   d) **None of the above.**

3. **Which of the following dealer cannot opt for composition scheme?**

   a) **a manufacturer or a dealer who sells goods in the course of inter-state trade or commerce**

   b) **a dealer who sells goods in the course of import into or export out of the territory of India**

   c) **a dealer transferring goods outside the State otherwise than by way of sale or for execution of works contract**

   d) **All of the above**

4. **Which of the following statement is true?**

   a) **The composition scheme is optional.**

   b) **A dealer availing composition scheme need not maintain any statutory records as prescribed under the State VAT Act.**

   c) **A dealer availing composition scheme should not have stock of goods brought from outside the State on the day he exercises his option and should not use any goods brought from outside the State after such date.**

   d) **All of the above**

Answers

1. **(a); 2. (c); 3. (d); 4. (d).**

VALUE ADDED TAX ~ IV

Vat Procedures

1. REGISTRATION

Registration is the process of obtaining certificate of registration (RC) from the authorities under the VAT Acts. A dealer registered under the VAT Acts is called a registered dealer. Any dealer, who intends to carry on the business of purchase and sale of goods in the State and is liable to pay tax, cannot carry on the business unless he is registered and holds a valid registration certificate under the Act.

a) Eligibility for registration

As per the provisions contained in the White Paper, registration of dealers with gross annual turnover above Rs. 5 lakh will be compulsory. There will be provision for voluntary registration. All existing dealers will be automatically registered under the VAT Act. A new dealer will be allowed 30 days time from the date of liability to get registered. An application for registration should be made to the VAT Commissioner.

The White Paper specifies that registration under the VAT Act will not be compulsory for the small dealers with gross annual turnover not exceeding Rs. 5 lakhs. However, the Empowered Committee of State Finance Ministers subsequently allowed the States to increase the threshold limit for the small dealers to Rs. 10 lakhs with the condition that the concerned State would bear the revenue loss, on account of increase in limit beyond Rs. 5 lakhs.

Generally, a dealer means any person, who consequent to, or in connection with, or incidental to, or in the course of his business, buys or sells goods for a consideration or otherwise.

b) Compulsory registration

If an assessee fails to obtain registration under the VAT Act, he may be registered compulsorily by the Commissioner. The Commissioner may assess the tax due from such person on the basis of evidence available with him. In this event the assessee shall have to forthwith pay such amount of tax. Further, failure to get registered shall result in attracting default penalty and forfeiture of eligibility to set off all input tax credit related to the period prior to the compulsory registration.

c) Voluntary registration

A dealer otherwise not eligible for registration may also obtain registration if the Commissioner is satisfied that the business of the applicant requires registration. The Commissioner may also impose any terms or conditions that he thinks fit.

d) Cancellation of registration

The registration can be cancelled on :

(i) discontinuance of business; or

(ii) disposal of business; or

(iii) transfer of business to a new location; or

(iv) annual turnover of a manufacturer or a trader dealing in designated goods falling below the specified amount.

2. TAX PAYER'S IDENTIFICATION NUMBER (TIN)

Tax Payer's Identification Number (TIN) is a code to identify a tax payer. It is the registration number of the dealer. The taxpayer's identification number will consist of 11 digit numerals throughout the country. First two characters will represent the State code as used by the Union Ministry of Home Affairs. The set-up of the next nine characters will be, however, different in different States. TIN will facilitate computer applications, such as detecting stop filers and delinquent accounts. TIN will help cross-check information on tax payer compliance, for example, the selective cross-checking of sales and purchases among VAT taxpayers.

3. VAT INVOICE

Invoice is a document listing goods sold with price, tax charged and other details as may be prescribed and issued by a dealer authorized under the Act.

The whole structure of the VAT with input tax credit is founded on the documentation of a tax invoice, a cash memo or a bill. The White Paper mainly provides for the following provisions, which are mandatory, and failure to comply with these attracts penalty :

(i) Every registered dealer whose turnover of sales exceeds the specified amount shall issue to the purchaser a serially numbered tax invoice, cash memo or bill with the prescribed particulars.

(ii) The tax invoice shall be dated and signed by the dealer or his regular employee, showing the required particulars.

(iii) The dealer shall keep a counterfoil or duplicate of such tax invoice duly signed and dated.

a) Importance of VAT Invoice (Tax Invoice)

Invoices are crucial documents for administering VAT. In the absence of invoices VAT paid by the dealer earlier cannot be claimed as set off. Invoices should be preserved with full care. In case any original invoice is lost or misplaced, a duplicate authenticated copy must be obtained from the issuing dealer.

A VAT invoice :

(i) helps in determining the input tax credit;

(ii) prevents cascading effect of taxes;

(iii) facilitates multi-point taxation on the value addition;

(iv) promotes assurance of invoices;

(v) assists in performing audit and investigation activities effectively;

(vi) checks evasion of tax.

b) Contents of VAT Invoice (Tax Invoice)

VAT legislations of all States provide for the contents of the tax invoice. By and large there would be no need for a separate tax invoice, a regular invoice can also be termed as tax invoice if it has the prescribed contents. Generally, the various legislations provide that the tax invoice should have the following contents :

(i) the words **"Tax Invoice"** in a prominent place;

(ii) name and address of the selling dealer;

(iii) registration number of the selling dealer;

(iv) name and address of the purchasing dealer;

(v) registration number of the purchasing dealer (may not be required under all VAT legislations);

(vi) pre-printed or self-generated serial number;

(vii) date of issue;

(viii) description, quantity and value of goods sold;

(ix) rate and amount of tax charged in respect of taxable goods;

(x) signature of the selling dealer or his regular employee duly authorized by him for such purpose.

c) Format of a VAT Invoice (Tax Invoice)

No prescribed statutory format is given for tax invoice in the White Paper or in any State VAT Act. Only the contents of the tax invoice have been prescribed. However, a standard format of the same may look like the one given below :

T A X   I N V O I C E *

ORIGINAL – BUYER'S COPY

Tax Invoice No. :
Date :
Challan No. and Date :

Seller's Name :	**Buyer's Name :**
Address :	**Address :**
Phone No. :	**Phone No. :**
VAT Registration No. :	**VAT Registration No., if any :**
CST Registration No. :	**CST Registration No., if any :**

Sl. No.	Quantity	Description of goods	Price Per Unit	Value (Rs)	VAT Rate	Tax Amount	Total (Rs.)
1.	1 pair	Leather shoes	450.00	450.00	12.5%	56.25	506.25
2.	1 piece	Leather bag	250.00	250.00	12.5%	31.25	281.25
3.	2 pairs	Socks	75.00	150.00	4%	6.00	156.00
						Total	943.50

Rupees Nine hundred forty three and fifty paise only.

E & O.E.

Signature
(of selling dealer or his authorised employee)

*In case of manufacturing dealer, **"TAX INVOICE–CUM–EXCISE INVOICE"** may be mentioned, if required.

d) Composition Scheme

The provisions relating to tax invoice do not apply to a selling dealer who has opted to avail the composition scheme under the respective State VAT laws. Thus, a composition scheme dealer cannot issue a tax invoice.

4. RECORDS

The following records should be maintained under VAT system :

(i) purchase records

(ii) sales records

(iii) VAT account

(iv) separate record of any exempt sale.

Further, the following records should also be kept and produced before an officer :

(i) copies of all invoices issued, in serial number;

(ii) copies of all credit and debit notes issued, in chronological order;

(iii) all purchase invoices, copies of customs entries, receipts for payment of customs duty or tax, and credit and debit notes received to be filed chronologically either by date of receipt or under each supplier's name;

(iv) details of the amount of tax charged on each sale or purchase;

(v) total of the output tax and the input tax in each period and a net total of the tax payable or the excess carried forward, as the case may be, at the end of each month;

(vi) details of goods manufactured and delivered from the factory;

(vii) details of each supply of goods from the business premises.

Failure to keep these records may attract penalty. All such records should be preserved for the period specified in respective State provisions.

No declaration forms

Most of the declaration forms that existed before the introduction of VAT have been dispensed with. Use of declaration forms is expected to be stopped completely. Lot of time and energy is wasted by the dealer in getting declaration forms from the department.

There is no provision for concessional sale under the VAT Acts since the provision for set-off makes the input zero-rated. Hence, there will be no need for declaration form.

5. RETURNS

Under VAT laws there are simple forms of returns. Returns are to be filed monthly/quarterly/annually as per the provisions of the State Acts/Rules. Returns will be accompanied with the payment challans. Some States have devised return-cum-challans. In these cases the returns along with the payment can be filed with the treasury.

A registered dealer may be required to file a monthly/quarterly/annual return along with the requisite details such as output tax liability, value of input tax credit, payment of VAT etc. Opportunity may be provided to lodge revised returns.

Every return furnished shall be scrutinized expeditiously within the prescribed time limit from the date of filing the return. If any technical mistake is detected on scrutinizing, the dealer shall be required to pay the deficit appropriately.

Return filing procedures under VAT laws are designed with the objective of :

(i) reducing the compliance costs incurred by the businesses in completing and filing their returns; and

(ii) encouraging businesses to comply with their obligations to file returns and pay VAT through the application of penalties in case of late payment of VAT and late filling of returns; and

(iii) ensuring the efficient processing of the data included in the returns.

6. ASSESSMENT

The basic simplification of VAT is with reference to assessment. Under VAT system, there is no compulsory assessment at the end of each year. The VAT liability is self-assessed by the dealer himself in terms of submission of returns after setting off the tax credit. The other procedures are also simple in all the States.

Deemed assessment concept is a major feature of the VAT. If no specific notice is issued proposing departmental audit of the books of account of the dealer within the time limit specified in the Act, the dealer will be deemed to have been self-assessed on the basis of the returns submitted by him.

VAT pre-supposes that all the dealers are honest. Scrutiny may be done in cases where a doubt arises of under-reporting of transaction or evasion of tax. Honest dealers will be protected and fictitious or dishonest would be penalized heavily.

System of cross checking

In the VAT system more emphasis has been laid on self-assessment. Hence, a system of cross-checking is essential. Dealers may be asked to submit the list of sales or purchases above a certain monetary value or to give the dealer-wise list from whom or to whom the goods have been purchased/sold for values exceeding a prescribed monetary ceiling.

A cross-checking computerized system is being worked out on the basis of coordination between the tax authorities of the State Governments and the authorities of Central Excise and Income-tax to compare constantly the tax returns and set-off documents of VAT system of the States and those of Central Excise and Income-tax. This comprehensive cross-checking system will help reduce tax evasion and also lead to significant growth of tax revenue. At the same time, by protecting the interests of tax-complying dealers against the unfair practices of tax-evaders, the system will also bring in more equal competition in the sphere of trade and industry.

7. AUDIT

In the VAT system considerable weightage is placed on audit work in place of routine assessment work.

Correctness of self-assessment will be checked through a system of Departmental Audit. A certain percentage of the dealers will be taken up for audit every year on a scientific basis. If, however, evasion is detected during the course of audit, the previous records of the concerned dealer may be taken up for audit.

Authorized officers of the department will visit the business place of the dealer to conduct the audit. The auditors will examine the correctness of the returns as well as the books of account of the dealer or any other information available with them. They will be equipped with the information gathered from various agencies such as suppliers, income tax department, excise and customs department, banks etc. Officers of the higher rank will supervise to ensure that the audit work is done in a free, fearless and impartial manner.

Accounts to be audited in certain cases

Under the sales-tax laws, tax evasion is considered to be on a large scale. The sales-tax departments of various States have not been able to effectively check the menace of tax avoidance and tax evasion. Therefore, apart from the departmental audit many States have also incorporated the concept of audit of accounts by chartered accountants.

The State of West Bengal has prescribed an elaborate list of particulars to be furnished by the dealers. These particulars have to be verified by the VAT auditor.

However, auditing for all types of dealers may not be necessary. The selection of cases for auditing has to be made in accordance with the criteria of the size of dealers.

In Maharashtra and Rajasthan, the dealer whose turnover exceeds Rs. 40 lakhs in any year is required to get his accounts audited in respect of such year while in West Bengal this limit is Rs. 1 Crore at present.

8. PENAL PROVISIONS

Since VAT is purely a State subject, States will have incorporated penal provisions as per their requirements. However, these are in general more stringent than those in the earlier sales tax laws. Since, the State taxation laws have allowed certain additional benefits in the form of input tax credit, which was not available earlier, they have introduced more stringent penal provisions to discourage evasion of taxes.

9. TAX RATES UNDER VAT

Under the VAT system, there are only two Basic VAT rates of 4% and 12.5% plus a specific category of tax-exempted goods and a Special VAT rate of 1% for gold and silver ornaments, etc. Thus the multiplicity of rates in the sales-tax system has been done away with under the VAT system.

a) Exempted category

Under exempted category, there are about 50 commodities comprising of natural and unprocessed products in unorganised sector, items which are legally barred from taxation and items which have social implications.

b) 1% Category

The special rate of 1% is meant for precious stones, bullion, gold and silver ornaments etc.

c) 4% VAT category

Under 4% VAT rate category, there are largest number of goods, common for all the States, comprising of items of basic necessities such as medicines and drugs, all agricultural and industrial inputs, capital goods and declared goods. The schedule of commodities is attached to the VAT Acts of the States.

d) 12.5% category

The remaining commodities, common for all the States, fall under the general VAT rate of 12.5%.

e) Non-VAT goods

Petrol, diesel, ATF (aviation turbine fuel), other motor spirit, liquor and lottery tickets are kept outside VAT. The States may or may not bring these commodities under VAT laws. However, it is agreed that all these commodities will be subjected to 20% floor rate of tax.

10. MISCELLANEOUS

a) Coverage of goods under VAT

In general, all the goods, including declared goods are covered under VAT and get the benefit of input tax credit.

The few goods which are outside VAT are liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirit since their prices are not fully market determined. These will continue to be taxed under the Sales-tax Act or any other State Act or even by making special provisions in the VAT Act itself at uniform floor rates decided by the Empowered Committee.

b) Stock transfer

Inter-State transfers do not involve sale and, therefore they are not subjected to sales-tax. The same position continues under VAT.

However, the tax paid on :

(i) inputs used in the manufacture of finished goods which are stock transferred; or

(ii) purchases of goods which are stock transferred

will be available as input tax credit after retention of 4% of such tax by the State Governments.

c) Reverse credit

In case where a registered dealer avails of input tax credit for purchase of goods and subsequently disposes of such goods not in accordance with the provisions of the VAT Act, then the input tax credit so availed of shall be deducted from the input tax credit of the tax period during which such occasion arises.

Following are some of the instances where reversal of input tax credit will take place in the tax period when such occasion arises :

(i) goods purchased and subsequently returned to the seller for any reason whatsoever;

(ii) goods purchased for business but used for personal consumption, gift or given out as free samples;

(iii) goods stolen or destroyed;

(iv) goods remaining in stock at the time of closure of business.

Note **:** Goods purchased intra-State and subsequently transferred to other States, otherwise than by way of sale (like branch transfer or transfer to an agent), will lead to a reversal of input tax credit to the extent of 4%.

For example, a dealer purchases television sets on payment of VAT at the rate of 12.5% in West Bengal in May, 2010 and avails of full input tax credit but subsequently transfers the same to his branch office outside the State in July, 2010. He will have to reverse 4% of input tax credit in July, 2010. In other words the dealer is entitled to avail of only 8.5% of input tax as input tax credit and 4% is ineligible.

(i) Compensation for losses

Although the introduction of VAT may, after a few years, lead to revenue growth, there may be a loss of revenue in some States in the initial years of transition. Some of the State Governments were resistant to introduce VAT account of this reason. The Government of India therefore agreed to compensate for 100 per cent of the loss in the first year, 75 per cent of the loss in the second year and 50 per cent of the loss in the third year of introduction of VAT. The loss would be computed on the basis of an agreed formula. This position was not only reaffirmed by the Union Finance Minister in his Budget Speech of 2004-05, but a concrete formula for this compensation has also been worked out after interaction between the Union Finance Minister and the Empowered Committee. However, in the first year of introduction, only a few States have claimed such compensation.

(ii) Imports into the VAT chain

Presently States do not have powers to levy a tax on imports. It is also essential to bring imports into the VAT chain. This will need a constitutional amendment. Because of the availability of set-off, not only cascading effect would be reduced but tax compliance would also improve. The Empowered Committee is discussing this issue with the Government of India.

Declared Goods [Section 2 (c) the Central Sales Tax Act, 1956]

"Declared goods" means goods declared under Section 14 of the Central Sales Tax Act, 1956 to be of special importance in inter-State trade or commerce.

Section 14 of the Central Sales Tax Act, 1956 :

Section 14 gives list of **'goods of special importance'** called **'declared goods'**. Important among them are :

(a) Cereals i.e. paddy, rice, wheat, bajra, jowar, barley etc.

(b) Coal and coke in all forms excluding charcoal.

(c) Crude oil

(d) Hides and skins.

(e) Jute.

(f) Oil seeds i.e. groundnut, til, cotton seed, linseed, castor, coconut, sunflower, mahua, kokum, sal etc.

(g) Pulses i.e. gram, tur, moong, masur, urad etc.

(h) Sugar and Khandsari sugar.

Section 15 of the Central Sales Tax Act, 1956 :

Section 15 of the Central Sales Tax Act, 1956 places following restriction and conditions in regard to powers of the State Governments to impose tax on declared goods inside the State :

(a) Tax on declared goods within the State cannot exceed 4%.

(b) If any declared goods, on which intra-State sales tax (i.e. State sales tax) is paid; is sold in inter-State sale; then the tax levied on sale within the State should be reimbursed to the person making such inter-State sale.

(c) If paddy is taxed within State and rice (which is produced from paddy) is also taxed, tax paid on paddy should be given set-off while levying tax on rice.

(d) Each of the pulses whether whole or separated shall be treated as a single commodity for the purpose of levy of tax under State Tax Law i.e. if tax is paid on raw pulses, no further tax is payable after it is processed.

Illustration on records to be maintained by a VAT Dealer

Transactions of a trader dealing in Leather Goods and Accessories

Sl. No.	Date	Transactions	Amount Rupees	Tax Rate %	Tax amount Rupees	Total Value Rupees
1	01.4.2010	Purchase of leather shoes	10000.00	12.50%	1250.00	11250.00
2	02.4.2010	Purchase of ladies' leather bags	6000.00	12.50%	750.00	6750.00
3	03.4.2010	Purchase of size measuring stool	800.00	12.50%	100.00	900.00
4	04.4.2010	Sale of leather shoes	2000.00	12.50%	250.00	2250.00
5	05.4.2010	Sale of leather shoes	1000.00	12.50%	125.00	1125.00
6	06.4.2010	Purchase of leather suitcases	8000.00	12.50%	1000.00	9000.00
7	07.4.2010	Sale of ladies' bags	3000.00	12.50%	375.00	3375.00
8	08.4.2010	Purchase of gents' purse	1000.00	12.50%	125.00	1125.00
9	09.4.2010	Purchase of office stationery	600.00	4.00%	24.00	624.00
10	10.4.2010	Sale of leather suitcases	2000.00	12.50%	250.00	2250.00
11	11.4.2010	Purchase of Cash Register Machine	2200.00	12.50%	275.00	2475.00
12	12.4.2010	Sale of gents' purse	400.00	12.50%	50.00	450.00
13	13.4.2010	Purchase of leather shoes	8000.00	12.50%	1000.00	9000.00
14	14.4.2010	Purchase of gents' leather belts	2000.00	12.50%	250.00	2250.00
15	15.4.2010	Sale of leather shoes	1800.00	12.50%	225.00	2025.00
16	16.4.2010	Purchase of leather belt	200.00	12.50%	25.00	225.00
17	17.4.2010	Purchase of leather pouch	1000.00	12.50%	125.00	1125.00
18	18.4.2010	Sale of gents' leather belts	400.00	12.50%	50.00	450.00
19	19.4.2010	Sale of leather shoes	2000.00	12.50%	250.00	2250.00
20	20.4.2010	Sale of leather pouch	400.00	12.50%	50.00	450.00
21	21.4.2010	Sale of ladies' leather bags	1000.00	12.50%	125.00	1125.00
22	22.4.2010	Purchase of office stationery	400.00	4.00%	16.00	416.00
23	23.4.2010	Sale of leather shoes	2000.00	12.50%	250.00	2250.00
24	24.4.2010	Sale of gents' leather belts	200.00	12.50%	25.00	225.00
25	25.4.2010	Sale of leather shoes	1000.00	12.50%	125.00	1125.00
26	26.4.2010	Purchase of socks	3000.00	4.00%	120.00	3120.00
27	26.4.2010	Sale of leather shoes	1500.00	12.50%	187.50	1687.50
28	26.4.2010	Sale of leather shoes	2000.00	12.50%	250.00	2250.00
29	26.4.2010	Sale of leather shoes	3000.00	12.50%	375.00	3375.00
30	26.4.2010	Sale of leather shoes	2000.00	12.50%	250.00	2250.00
31	26.4.2010	Sale of socks	1500.00	4.00%	60.00	1560.00

Other Information :

1. Shoes sold on 25th April, 2010 were returned by the customer on 29th April.
2. One pair of shoes, out of the purchase made on the 1st April, 2010, was taken by the Proprietor for his own use on 30th April, 2010. The input tax involved is Rs. 150.00.

INPUT TAX ACCOUNT

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
01.04.2010	To Party (Supplier) A/c [or Cash / Bank A/c]	1250.00	01.04.2010	By Input tax credit A/c*	1250.00
02.04.2010	-do-	750.00	02.04.2010	-do-*	750.00
03.04.2010	-do-	100.00	03.04.2010	-do-*	**100.00
06.04.2010	-do-	1000.00	06.04.2010	-do-*	1000.00
08.04.2010	-do-	125.00	08.04.2010	-do-*	125.00
09.04.2010	-do-	24.00	09.04.2010	By Office stationery A/c*	24.00
11.04.2010	-do-	275.00	11.04.2010	By Office equipment A/c*	275.00
13.04.2010	-do-	1000.00	13.04.2010	By Input tax credit A/c*	1000.00
14.04.2010	-do-	250.00	14.04.2010	-do-*	250.00
16.04.2010	-do-	25.00	16.04.2010	-do-*	25.00
17.04.2010	-do-	125.00	17.04.2010	-do-*	125.00
22.04.2010	-do-	16.00	22.04.2010	By office stationery A/c*	16.00
26.04.2010	-do-	120.00	26.04.2010	By Input tax credit A/c*	120.00
30.04.2010	To Input tax credit A/c [reversal of credit]	150.00	30.04.2010	By Purchase A/C*	150.00
		5210.00			**5210.00**

*Instead of daily entry a single consolidated entry may be made at the end of the tax period.

** Provided that the item is capitalised in dealer's books of account.

Notes :

1. Input tax account will be debited with the tax amount only to the extent which has been paid by a registered dealer, other than those who opt to pay tax at the compounded rate.

2. The portion of the input tax, on which input tax credit is available shall be transferred to the input tax credit A/c and the portion on which no input tax credit is available is to be transferred to other accounts like Purchase A/c or Office equipment A/c or Office stationery A/c, etc., as the case may be.

INPUT TAX CREDIT ACCOUNT

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
01.04.2010	To Input tax A/c	1250.00	30.04.2010	By Input tax A/c [reversal of credit]	150.00
02.04.2010	-do-	750.00	30.04.2010	By Output tax A/c	3147.50
03.04.2010	-do-	100.00	30.04.2010	By Balance C/F	1447.50
06.04.2010	-do-	1000.00			
08.04.2010	-do-	125.00			
13.04.2010	-do-	1000.00			
14.04.2010	-do-	250.00			
16.04.2010	-do-	25.00			
17.04.2010	-do-	125.00			
26.04.2010	-do-	120.00			
		4745.00			**4745.00**
01.05.2010	To Balance B/F	1447.50			

OUTPUT TAX ACCOUNT

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
29.04.2010	To Party (Customer) A/c [or Cash / Bank A/c] (Goods returned)	125.00	04.04.2010	By Party (Customer) A/c [or Cash / Bank A/c]	250.00
30.04.2010	To Input tax credit A/c	3147.50	05.04.2010	-do-	125.00
			07.04.2010	-do-	375.00
			10.04.2010	-do-	250.00
			12.04.2010	-do-	50.00
			15.04.2010	-do-	225.00
			18.04.2010	-do-	50.00
			19.04.2010	-do-	250.00
			20.04.2010	-do-	50.00
			21.04.2010	-do-	125.00
			23.04.2010	-do-	250.00
			24.04.2010	-do-	25.00
			25.04.2010	-do-	125.00
			26.04.2010	-do- (187.50+250+375+250+60)	1122.50
		3272.50			**3272.50**

Note :

Since the dealer's amount of input tax credit for the month of April, 2010 is in excess of his output tax, net tax payable for the month will be Nil and the input tax credit of Rs. 1,447.50, being in excess, will be carried forward to the next month, that is May, 2010.

VALUE ADDED TAX ~ IV

Self-examination questions

1. **Who should obtain registration under VAT laws?**

   a) **Any person who desires to provide taxable services.**

   b) **Any dealer, who intends to carry on the business of purchase and sale of goods in the State and is liable to pay tax.**

   c) **Any dealer, who intends to carry on the business of purchase and sale of goods in the State.**

   d) **None of the above**

2. **The registration can be cancelled on :**

   a) **discontinuance of business**

   b) **disposal of business**

   c) **transfer of business to a new location**

   d) **All of the above**

3. **The taxpayer's identification number will consist of ________ digit numerals throughout the country.**

   a) **10**

   b) **12**

   c) **11**

   d) **9**

4. **The tax invoice shall be dated and signed :**

   a) **only by the dealer**

   b) **only by his regular employee**

   c) **by the dealer or his regular employee**

   d) **None of the above**

5. **Under VAT system :**

   a) **there will be compulsory assessment at the end of each year**

   b) **the VAT liability will be self-assessed by the dealer himself.**

   c) **either compulsory assessment or self-assessment will be made**

   d) **None of the above**

6. The basic tax rates prescribed under VAT laws are:

a) 4%, 12.5% and 1%

b) 4% and 12.5%

c) 2%, 4% and 10%

d) 3%, 4% and 8%

7. Which of the following records should be maintained under VAT laws?

a) Purchase records

b) Sales records

c) VAT account

d) All of the above

Answers

1. (b); 2. (d); 3. (c); 4; (c). 5; (b). 6; (b). 7; (d).