

TAXONOMY OF VAT

Question 1

Briefly discuss the different variants of VAT.

(2 Marks) (May 2011)

Answer

The three variants of VAT are (a) Gross Product Variant, (b) Income Variant and (c) Consumption Variant.

1. Gross Product Variant: Tax is levied on all sales and deduction for tax paid on inputs excluding capital inputs is allowed.
2. Income Variant: Tax is levied on all sales with set-off for tax paid on inputs and only depreciation on capital goods.
3. Consumption Variant: Tax is levied on all sales with deduction for tax paid on all business inputs (including capital goods).

Question 2

Write a brief note on the deficiencies of the VAT system.

(4 Marks) (Nov 2010)

Answer

1. One of the key deficiencies of the VAT system is that there is lack of uniformity in rates of tax across the states. Distortions also arise on account of differences in classification of the product and concessions or exemptions like composition schemes, exempted category of goods in certain States.
2. The other feature is that central sales tax (which is an origin based tax) has been allowed to coexist with VAT (which is essentially destination based tax) in a system where central sales tax payments are not eligible for set off in the receiving State.
3. There is a burden of record keeping for small traders even though they could switch over to a simplified composition scheme without the benefit of input credit. This could add to the supply chain cost because of the non availability of input credit when the goods pass through a small trader under the composition scheme.
4. The administration cost to the State owing to increase in the number of dealers could go up.

5. Another possible weak point in the introduction of VAT, which will have an adverse impact 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.
6. It is claimed that VAT is regressive, i.e. its burden falls disproportionately on the poor since the poor are likely to spend more of their income than the relatively rich person.

Note: Any four points may be given.