Value Added Tax (VAT)

VAT is levied on sale of goods. It was introduced in lieu of sales tax. It is the tax paid by the producers, manufacturers, retailers or any other dealers, who add value to the goods and that is ultimately passed on to the consumer. VAT is a multi-point sales tax with set off for tax paid on purchases. It is basically a tax on the value addition on the product. The burden of tax is ultimately born by the consumer of goods.

VAT enhances competitiveness by removing the cascading effect of taxes on goods and makes the levy of tax simple and self-regulatory, ensuring flexibility to generate large revenues. The cascading effect is brought about by the existing structure of taxation where inputs are taxed before a commodity is produced and the output is taxed after it is produced. This causes an unfair double-taxation. However, in VAT, a set-off is given for input tax (tax paid on purchases). This results in the overall tax burden being rationalized and a fall in prices of goods.

VAT in our country is basically a State subject and all the States have separate VAT Acts and Rules. In our country the Vat in real sense was introduced in 2005 though before that some of the states like Maharashtra (introduced and taken back) and Haryana experimented it but only success before 2005 was Haryana State, which successfully introduced VAT in 2003 itself. The schedule of all the States with regard to implementation of VAT is as under:-

STATES	DATE OF IMPOSITION OF VAT	NUMBER OF STATES
1.Haryana	1-4-2003	1
2. Andhra Pradesh, West Bengal, Kerala, Karnataka, Orissa, NCT Delhi, Tripura, Bihar, Arunachal Pradesh, Sikkim, Punjab, Goa, Mizoram, Nagaland, Jammu and Kashmir, Manipur, Maharashtra, Himachal Pradesh, Assam and Meghalaya.	1-4-2005	20
3.Uttaranchal	1-10-2005	1
4. Rajasthan, Gujarat, MP, Chhatisgarh and Jharkhand.	1-4-2006	5
5.Uttar Pradesh and Tamil Nadu	After 2006	2

The VAT is a multipoint taxation system in which the seller collects tax from the purchaser at each stage of sell but at the time of deposit of the same to the Government, the tax paid by the seller on his own purchases is deducted.

Meaning of VAT for a Manufacturer:-

The Manufacturing Company Lucky Shoes Limited has purchased raw material worth ` 50,000 after paying VAT of ` 2000 @ 4%. The Labour contents are ` 40,000 and the margin towards administrative and selling expenses and profit is ` 10,000. Hence, the total sell price is ` 100000. Suppose the tax rate is 12.5%, he will charge ` 12,500 as tax from the whole seller. Since he has already paid tax of ` 2000 on the raw material hence his net tax liability will be ` 10,500 after getting a credit of ` 2,000 tax paid by him on Raw material.

Meaning of VAT for a Whole-Seller

The whole seller Radhey has purchase goods worth ` 1,00,000 after paying tax of ` 12,500 as mentioned above. Let assume his margin for profit and expenses is ` 7,000 then he will sell the goods for ` 1,07,000 to the retailer and also charge tax of ` 13,375 from the retailer.

Since he has already paid tax of ` 12, 500 on his purchases hence his net tax liability will be ` 13,375 - ` 12,500 = 875.

Since the expenses and margin of profit for the whole seller is ` 7,000 and this is the value added to the product by the whole seller and VAT is ` 875 and one can calculate it as 12.5% on ` 7,000.

Meaning of VAT for a Retailer

The retailer Mohan has purchased goods for ` 1,07,000 after paying tax of ` 13,375. Suppose his margin for profit and expenses is ` 10,000 thus he will sell the goods to the customer at ` 1,17,000 and charged tax of ` 14,625. His net tax liability will be ` 14,625 – 13,375 = 1,250 and we can verify it as 12.5% of ` 10,000 since the value added by the retailer is ` 10000.

THE SYSTEM OF TAXING THE SALE OF GOODS BEFORE VAT WAS:

In pre-VAT era, we have a single point sales tax system in which the tax is charged on first point of sale and thereafter no tax was payable on further points of sale and goods were sold Sales Tax Paid (STP) on all such further sales within the State. Example: -

FIRST SALE: X and Company, a manufacturer of refined edible oil, sold 1000 tins of the oil to **Y and company,** a wholesale trader and the rate of State Sales Tax on edible oil was 4% and rate of edible oil was ` 1,000 per tin. The total sale price of goods excluding sales tax was ` 10 Lakhs and sales tax on this amount was ` 40,000. Hence the total cost of goods for **Y and company** is ` 10.40 Lakhs including tax.

SECOND SALE : Now the per tin cost of oil for **Y and company** is ` 1040 and if after adding its profit @ 5% the goods were sold by **Y and Company** to retailers at ` 1092 and this is the sale price for **Y and company** and the Goods are sold **Sales tax paid** or more better known as **STP** and no further tax is required to be paid.

FINAL SALE TO CONSUMER: The cost for the retailer was ` 1092 and if the goods are sold by the retailers after adding 10% as their profit then the sale price for the retailer was ` 1200 and here also the retailer have sold the goods to the consumer without paying further tax i.e. goods were sold STP.

Here the ultimate sale of goods to the consumer was at ` 1200 but the Government had received tax only ` 40 i.e. on ` 1000, the sale price of the Manufacturer. The value addition from wholesaler to retailer and retailer to consumer remained tax-free.

In VAT, tax is charged on value addition on each point of sale, hence it is called Value Added Tax. In simple words value added is the difference between the sale price and purchase price for all these THREE segments of the economy and VAT is a tax on this value added by each chain of sales and in that sense it is a different from the age old traditional sales tax.

The tax collected by a dealer, who may be a manufacturer, whole-seller or retailer is termed as Output Tax (ie output tax is tax collected by the taxpayer on his sales) and tax paid by the seller on his own purchases is called input credit (Input tax credit is the tax paid by the dealer on eligible purchases) and the tax payable is the difference between the two.

Tax payable = Output Tax - Input credit

If for a tax period i.e. for one month or three months depending on the VAT laws of particular State, Input Credit is more than the Output Tax, then the balance tax will be carried forward to the next tax period or refunded to the tax payer, if the tax system of a particular State permits refunds for each tax period. Normally the tax is carried forward to next tax period and adjusted against the tax payable in the next tax period.

Example: A manufacturer of a State has purchased Raw material from the same state worth ` 1,00,000 after paying tax of ` 12,500 @ 12.5%. His input tax credit will be ` 12,500. If he sold goods worth ` 2,50,000 @ 12.5% then his output Tax will be ` 31,250 and his tax liability will be ` 18,750.

Input Tax Credit (ITC) is allowable only on the State purchases. The ITC is not allowable on the purchases from the other states ie interstate purchase. If the purchases are made from another State (i.e. CST purchases) then no ITC is available on the tax paid on goods purchases from other States by paying Central Sales Tax.

Reason: The CST is collected by the selling State and naturally the tax collected by the other states cannot be adjusted in another state.

Example. A dealer of Punjab has purchased goods worth ` 100000 from a dealer of Delhi after paying CST of ` 4000 during the course of interstate sales against 4% against form C. He sold these goods in his own state after charging LST of ` 13750. His tax paid is ` 4000 and he wants to take credit of ` 4000 CST paid by him. This credit of CST paid by him will not be available to him. The tax paid by him has been charged by the State of Delhi and it will not be possible for his own State Punjab to give credit of tax received by another State.

Since sales tax is a State subject hence this problem will remain in federal system of governance. The feasible solution will be phasing out of CST, which is being considered by the CG and phasing out of the CST has already started and the rate of CST has been reduced from 4% to 3% and then to 2% and at present the rate is 2% but the CG had promised to make it 1% in 2009 and then it was to be abolished. **At present the rate of CST is 2%.**

HISTORY OF VAT

The word and concept of VAT was first referred and proposed by **Dr. Wilhelm Von Siemens** in Germany in 1919 and he referred this concept as **Improved Turnover Tax** and in 1921 the same type of concept was also suggested by Professor Thomas S. Adams in USA. Again in 1949 VAT was recommended in JAPAN. These three gentlemen started the discussion on VAT in Germany (1919), USA (1921) and Japan (1949) and the overall world came to know something about VAT from these three initial discussions and references.

The discussions were started from Germany, USA and Japan but **France took the lead** and introduced VAT in 1954 and till 1960 remain the only country in the world to have the VAT in their taxation system. Ivory Coast was the second country to introduce VAT in 1960 followed by Senegal in 1961 and Denmark in 1967.

DIFFERENT VARIANTS OF VAT

There are three widely know format of VAT which can be described as under:-

- Gross product variant (GPR)
- Income Variant.
- Consumption Variant.

The most popular one is **Consumption Variant** and India has also implemented this type of VAT in which tax is collected on the entire sales amount and **credit of tax is given on all material and capital goods**.

In case of **Gross Product Variant**, the deduction is given only with respect to the inputs excluding the capital goods.

In case of **Income Variant,** the tax is collected on all the sales but credit is given on all the inputs and depreciation part of the capital goods.

The basic difference is the input credit of tax paid on capital Goods. In Gross Product Variant, ITC is not allowed on capital goods and in Income Variant, the ITC is allowed on tax paid on depreciation part of the capital goods. In the third one, in which the ITC is allowed on all the inputs i.e. material and capital goods is the most popular and logical variant of the VAT and the same is applied in most of the countries including India.

METHODS OF COMPUTATION OF VAT

Broadly we have three methods of calculation of VAT and these are:-

- Addition Method.
- Invoice Method.
- Subtraction Method.

The most logical system is invoice system and most of the countries including India have already implemented VAT on this system. The output tax is calculated on the basis of Sales invoice and further the ITC is also calculated on the basis of purchases invoice including the purchases invoice of capital goods eligible for ITC.

It is logical, practical and less cumbersome and easy to calculate. This is the invoice method of calculating the tax payable and it is very popular system.

Example:-

Sales Invoice

Sales price	` 10000
Vat 12.5%	` 1250 (Output Tax)
Total	` 11250

Purchase Invoice

Purchase price	` 9000
Vat 12.5%	` 1125 (Input Tax)

Tax Payable = Output Tax - Input Tax = 1250- 1125 = ` 125

Cross check = 12.5% on value addition of ` 1000 = ` 125

Since whole the calculation is based on Invoice system hence the method is called the Invoice method.

The Addition Method: Calculate all the value additions i.e. Labour, Expenses and profit. Here in that if the labour is ` 100 and expenses are ` 500 and rest of the amount from value addition is the profit of the dealer in the previous example. The value addition is ` 1000, which is the difference between the sale and purchase price. Now add all the expenses and profit say ` 100.00 + 500 + 400 (Profit) = ` 1000 and calculate 12.5% of ` 1000 and this amount is ` 125 and this is the tax payable by the dealer.

Since the tax is payable on addition of all expenses and profit hence this is called addition method.

This is not very popular version because the calculation and payment of tax is not matched with the invoices received (Purchases) and invoice issued (Sales) hence the check of Tax evasion is not possible.

Subtraction Method: This method is very simple and in this method one has to pay tax directly on the difference between the sale and purchase price. Calculate the tax by applying the rate on difference between sale and purchase (exclusive of Tax). Here, the Goods sold by a manufacturer to distributor is ` 5000 exclusive of tax and the distributor is selling it on ` 6250 exclusive of Tax then the difference in purchase and sale price is ` 1250 and if the rate of tax is 12.5% then the tax payable is 12.5% on ` 1250 and comes to ` 156.25.

Difference in the three systems: If the rate of tax is the same then there will be no difference in overall payment of tax but see at present practically the rate of tax on input is not the same some inputs (Raw Material) are taxable at 4% though the output (The finished product) is taxable at 12.5% or vice versa and in that case the perfect result can only be ascertained form the Invoice system hence this system is most acceptable.

The result of invoice, addition and subtraction method in case of same tax rate is same but if the rate is different, then in case of **Invoice Method** the whole goods is taxable at the rate applicable on final product and if the raw material is taxable at less tax then the revenue (i.e. the Government) is compensated and if the raw material is taxable at higher rate than the final product then the Tax payer will get the benefit. Example:-

Sale price	` 10000	(Tax rate 12.5% - 1250)
Raw material	` 6000	(Tax Rate 4% - 240)
Labour	` 2000	
Expenses	` 1000	
Profit	` 1000	

Invoice Method:- -

Tax payable- Out put Tax 1250 - Input Tax 240= **1010**

Now analyse this tax:- 12.5% on value addition of ` 4000 = 500

Plus the difference of Tax on ` 6000 @ 8.5% = 510

Total tax = **1010 (Same)**

Government revenue = 240 (Tax on raw material) + 1010 (Tax on finished goods)= 1250

Here the raw material was only taxed @ 4% hence additional tax has been imposed on it @ 8.5% to make it taxable at the rate of tax on final product.

Here in addition system:- Add labour 2000+ Expense 1000 + Profit 1000= 4000.

Hence the tax payable is ` 500

The Government got ` 240 earlier on raw material hence total tax is ` 740 and got the less tax of ` 510 (from invoice method 1010 on final product + 240 on Raw material= 1250- 740= 510) and this ` 510 is the tax @ 8.5% on ` 6000 = ` 510. The Invoice system takes the care of this automatically but in case of addition and subtraction system this is the big drawback of these two systems hence the Invoice system is accepted by most of the countries.

Merits of VAT

Vat is a scientific and logical taxation system, in which the last consumer knows about his contribution to the tax. We have some merits of the Taxation system as a whole and also from the age old sales tax system of taxing the sales of goods. The merits of the VAT are:-

1.No tax evasion
2. Neutrality
3.Certainty
4.Transparacy
5. Better revenue collection and stability.
6. Better accounting system.
7. Effect on retail price.

NO TAX EVASION

Since in VAT, the tax is payable on sales at each stage and out of which the tax paid by the seller on his purchases is deducted then if at any stage of sale tax is not paid then it will not affect the revenue because in that case no deduction is available to the seller and he has to pay the whole tax. Hence the possibility of evasion of tax is very remote.

Example:- X purchases goods worth ` 1000 after paying tax of ` 40 @ 4% and sold these goods at ` 1250 by applying tax @ 4%. The amount of Tax is ` 50. If he has no valid bill of purchases of goods then no credit is allowed to him and revenue will get ` 50 from him hence if at any point in the series of sales tax is not paid it will not affect the revenue. Hence it is said that there will be no tax evasion in VAT.

NEUTRALITY

VAT system does not interfere in the choice of the purchaser and this is because of systems inbuilt anti cascading effect. If there are two raw materials for production of single finished goods and A raw material is 4% taxable and B raw material is 12.5% taxable. Naturally the manufacturer will go for 4% Taxable raw material but in VAT it will not make any difference and choice of the manufacturer has nothing to do with the rate of tax because if the tax is paid at 12.5% then the manufacturer will get the credit of the same and if the tax is paid @ 4% he will get the credit @ 4%. Hence he has to consider the other merits excluding the rate of tax while selecting the raw material. This is the Magic of VAT.

CERTIANTY

In VAT the system of payment of VAT is simple and certain. Collect the tax on sales and deduct out of this the tax paid on purchases. No need to go for definition of Sales, turnover, purchases.

TRANSPARENCY

Buyer knows what he is contributing to tax is the transparency. In earlier system, tax is paid on first point and in the series of sales the last consumers did not know what amount has been included in the price of goods towards sales tax.

BETTER COLLECTION OF REVENUE

There is very little possibility of tax evasion under VAT, hence Better collection of Tax to the revenue. This in turn makes the VAT stable and flexible source of revenue. Stable in the sense that Government will get tax without evasion and flexible in the sense if the price increased then government will get the higher amount of tax.

In the old sales tax system, if one commodity is purchased by the dealer by paying ` 100 as cost and ` 4 as sales Tax but there is a sudden spurt in prices and the commodity is sold at ` 200 but since the system of tax was single point then no further tax is payable but in VAT the revenue will get tax on whole ` 200 hence this system is called stable (Govt. will get tax on every transaction of sales) and flexible also (Government will get tax on increased price also. One more benefit of flexibility of the system is that consumer will have to pay less tax if the prices got a negative turn.

BETTER ACCOUNTING SYSTEM

To get the credit of input tax and also calculate the output tax (Both are essential for calculating the tax liability of the dealer), the dealer has to prepare proper accounts within scheduled time hence it will certainly promote the better accounting system amongst the dealers.

DEMERITS OF VAT

Nothing is perfect in the world. But in case of Vat the demerits of VAT are mainly not the demerits of the basic VAT system but these demerits are attributed to the way in which system is applied in a particular country.

NEUTRALITY IS RESTRICTED TO STATE PURCHASES

VAT being a State subject, the benefit of neutrality is restricted to the purchases within the State and not applicable for the purchases from outside the state during the interstate transaction since no credit of interstate purchases is available.

INCREASE IN ADMINISTRATIVE COST

VAT is a complicated system hence it increase the accounting cost. This burden is more on small traders and firms. Further since the tax is paid at each stage hence it increases the working capital requirements.

ANTI POOR TAX

VAT is consumption tax and since the ratio of expenditure to income is more in the case of poor as far as consumption is concerned than the rich hence to that extend it can be termed that VAT is anti poor taxation system. This drawback of Vat can be neutralized by taxing the necessities at lower rate and luxuries at higher rate.

INCREASES ADMINISTRATIVE COST

And the last drawback of VAT is that it increases the administrative cost and this is automatically be compensated by increased revenue.

INPUT CREDIT

The tax liability is calculated as under

Tax due:- Output tax - Input tax credit

Output tax:- tax collected from the buyers by the dealer

Input tax credit:- Tax on purchases of the dealer which is eligible for set off against the out put tax

Input Tax Credit

ITC means the tax paid by the seller within the State on his purchases. Here all the purchases are not eligible for ITC, hence only eligible purchases are taken into account in the ITC. One thing should be noted that the purchases should be within the state.

EXAMPLE: - X and company has purchases raw material worth ` 1 lakh @ 4%, procession material @ 12.5% worth ` 0.25 Lakhs. Calculate the input credit of X and company on these purchases.

Description	Amount	Rate	ITC
Raw Material	1,00,000	4%	4000
Processing material	25,000	12.5%	3125
Total ITC			7125

Goods purchased for making the following sales shall be eligible for ITC:-

1.	**Goods purchased for Sales within the State**- Seller is from Rohtak (Haryana) and Purchaser is from Panipat (Haryana) i.e. both seller and purchasers are from the same state. This is called sales within the state and in that case the dealer of Rohtak who sale goods to the dealer of Panipat and collect tax from him and out of this tax he will deduct ITC on his own purchases which he has paid on his own purchases in the state of Haryana.
2.	**Goods purchased for Interstate sales**- More popularly known as CST sales. e.g the seller is from Rajasthan and the purchaser is from Haryana. The sales are called interstate sales i.e. sales between two States. It is called CST sales because it is governed the Central Sales Tax Act, but the revenue goes to the State Government of the selling dealer. The selling dealer will get the ITC on purchases made by him within the state if the Goods are sold in interstate sales since the revenue from interstate sales is also received by the State Government of the selling dealer and if the selling dealer has paid some tax in the State on his purchases to be sold in interstate sales, the same will be eligible for ITC.
3.	Raw Material, Packing Material, Consumable stores required for manufacturing of taxable Goods or packing of the same for sale within the State (as mentioned in 1 above) or sale during the sate (as mentioned in 2 above).
4.	**Goods purchased to be used in execution of works contract** - In case of works contract such as construction of Building etc. the material is used and the property (ownership) of the material is transferred to the awarder (who give the contract) by the awardee (i.e. the contractor) and to the extent of transfer of property in the material used in execution of works contract it is called sale and taxable under the VAT. If the tax is paid by the contractor while purchasing the goods then the same shall be eligible for ITC.
5.	**Capital goods to be used in manufacture or resale of taxable goods**- Capital goods means plant, machinery, furniture etc. and all these are taxable. If these capital goods are used for manufacturing of goods or are used for sale of goods then the ITC (i.e. tax paid within the state on purchase of capital goods) shall be allowed.
6.	The goods such as raw material, capital goods, consumable stores and spares and packing material which is used for manufacturing/packing of goods to be sold during the export shall also be eligible for input credit.
7.	Purchases for making the Zero rated sales.

If the purchases are made for a particular Raw material which can be used for making taxable goods as well as tax free goods, then how ITC will be allowed?

When eligible purchases are made and used partially for making of taxable goods and partially for making of tax free goods then the ITC shall be allowed proportionately.

Example: X and company purchased 1000 K.G of raw material amounting to ` 10 Lakhs by paying Vat @ 4% i.e. ` 40000. Now 75% of the material is used for making tax free goods and 25% for taxable goods. The ITC will be allowed for ` 10,000 only (25% of the tax paid) since only 25% is used for making the taxable goods.

Input Credit on Capital Goods

All the capital goods are not eligible for ITC in all the States. VAT is a State law hence each State has its own provisions and especially for ITC on capital Goods the provisions differs from State to State. The States have decided their own law in this respect. Some States allow it at once but the others in instalments. The maximum time period as suggested by White paper is 36 Months.

While some States have allowed ITC on all the capital goods and to all the dealers including the traders but others have only allowed the same to the manufacturers and further in some States the ITC on capital goods are available only on machinery and plants used for the purpose of manufacturing.

In Maharashtra it is allowed at once but in Rajasthan ITC on capital goods for bill up to ` 1 lakh is allowed at once but if the bill is more than ` one lakh then it will be allowed in 2 instalments and one is in September and other one is in March.

Type of purchases not eligible for ITC

1. **Purchases from unregistered dealers**: - Purchase from dealers who are not registered under the VAT law of the State and since they are not registered they are not paying tax hence the purchases for such dealers are not available for ITC.

2. **Purchase from dealers who opt for composition scheme**: - The small dealers who instead of going for VAT, opts for composition scheme by paying a certain percentage (decided by State upto maximum of 1%) of his turnover. If the dealer opts for composition scheme then the purchase from such dealer is not eligible for ITC.

3. States have the right to restrict any purchases being eligible for ITC and while dealing the VAT in particular State one has to go for special provision of that State to see what type of purchases are not eligible for ITC.

4. The purchases for which the purchasing dealer does not have the proper invoice and further if there is evidence that the same is not issued by the selling dealer then ITC will not be allowed. In the VAT invoice the tax should be separately charged and if the amount of tax is not separately shown in the invoice then the same will not be eligible for ITC.

5. **Purchase of goods which is used for manufacturing of exempted** goods. Exempted here means Tax free Goods.

6. **Purchase of goods which are not sold as taxable goods** i.e. which were used for personal purpose or distribute as Gifts to the customers or dealers.

7. Goods purchased from outside the State, which includes the interstate purchases and purchases during the course of import from other countries.

<u>GOODS SOLD OUTSITE THE STATE:-</u>

These purchases are not eligible for ITC. Further if goods are sold outside State on which no tax is paid or payable to the state in which purchases are made then the input credit is allowed to the extent of tax paid in excess of CST Rate.

What are sales outside the State (SOS)?

Since it is called SOS or consignment sale or depot sale. If the seller made outright sale then he will make a bill, charge tax (CST) in the case of interstate sales and deposit the same. Now suppose one dealer of A state has sent his goods to dealer of the another state for sale i.e. on consignment sale or to his own depot to sold there then this is not interstate sales and it is called consignment sales or branch transfer on which no tax is payable.

Example: - A dealer of State 'A' has sent his goods for consignment sale to a dealer of State 'B', since it is not a sale and merely a transfer of goods hence it is not taxable and if it is not taxable then state 'A' will not get any tax on it. Hence no ITC will be allowed on its purchases of goods which are sent for consignment sales to other States.

Though a provision has been suggested in the white paper that the restriction is only applicable up to the tax paid on 2 % rate and if tax is paid @ 12.5% then ITC will be allowed over and above 2% of the Tax i.e. 10.5% of the purchase price of goods will be allowed as ITC but if the tax paid is only 2% then No ITC will be allowed.

The CST is collected by the selling State and naturally the tax collected by the other states cannot be adjusted in another State. Example: A dealer of Punjab has purchased goods worth ` 1,00,000 from a dealer of Delhi after paying CST of ` 4000 during the course of interstate sales against 4% against form C. He sold these goods in his own state after charging LST of ` 13,750. His tax paid is ` 4,000 and he wants to take credit of ` 4000 CST paid by him. This credit of CST will not be available to him. The tax paid by him has been charged by the State of Delhi and it will not be possible for his own State Punjab to give credit of tax received by another State.

THE WHITE PAPER ON VAT

The introduction of VAT in our country was not as smooth as it appeared after its successful implementation. An Empowered Committee of Finance Ministers (ECSFM) of all the states was constituted under the chairmanship of Dr. Asim Das Gupta, the Finance Minister of West Bengal. First it was decided that the VAT would be introduced in 2003 i.e. from 1st. April 2003 but due to political situation and scheduled elections in most of the States VAT was postponed though Haryana was the only state to adopt VAT in 2003 itself. The ECSFM was appointed under the Leadership of Dr. Asim Das Gupta, the Finance of West Bengal. **Later in 2005 the VAT** was introduced in 20 states as stated in the schedule given above and before introduction of VAT a white paper was prepared by this ECSFM and released by the Finance Minister of the Country. In this White paper various modalities were set regarding procedural aspect of VAT alongwith the broad suggestive guidelines regarding this new concept of taxation in our country.

White paper is not a binding paper on the State, it was only suggestive but there was a broad agreement between the States on its major contents.

EXPORTS ARE ZERO RATED

Exports are Zero rated under VAT i.e. the input credit on the goods purchased for exports and goods used as raw material and packing material for exports will be available to the exporter and is refundable. All the states have made special provisions for early refund in this respect and White paper has set 3 Months time limit for making available the refunds to the dealers who are exporting the Goods.

TAX INVOICE

A proper Tax invoice containing the required details is the basic requirement of claiming input tax credit.In general, the states have prescribed the details of invoice without prescribing the standard Performa of the same.

Generally the Tax invoice must contain the name of selling dealer, his TIN, amount of tax charged coupled with the general information about the goods sold. Further it should be serially numbered and to be made in duplicate to keep one copy of the same with the selling dealer. The word **TAX INVOICE** should be mentioned on it prominently to make it different from Non vatable bills.

The tax is value added but there may be a situation when negative value addition i.e. the loss then what happened?

Value added tax has an inbuilt mechanism to take care of loss on sales and this unique feature of VAT give an upper hand to the VAT over traditional sales tax system. Let us see this system of compensating the unfortunate dealers sustain genuine business losses.

Example: - M/s Satya trading company has purchased goods worth ` 10,00,000 after paying tax of ` 40,000 @ 4% within the state. Due to fall in prices, the goods were sold by it for ` 8,00,000 after bearing the loss of ` 2,00,000. In the traditional sales tax system these goods were sold STP i.e. sales tax paid and no credit for excess payment of tax was available.

In VAT the input credit of tax is ` 40,000 and output Tax is ` 32,000 hence there is an excess of input credit of ` 8,000, which can be carried forward or can be claimed as refund as per the procedure laid down by state law.

SUPERIOR THAN SALES TAX SYSTEM

Transparent system

In VAT the last consumer is in a position to know the ultimate burden of tax since tax is written on each invoice issued by a VAT dealer.

A dealer who purchased some goods after paying tax within the State but these goods are not sold by him and remained in the stock. The same dealer has sold some other taxable goods and collected tax on it. The dealer can adjust the Tax paid by him on the goods purchased by him but not sold and remained in stock against the output tax of the other goods sold by him.

Example. M/s Mohan and company has purchased goods A worth ` 1,00,000 after paying tax of ` 12,500 within the state. This commodity they purchased with an intention to hold in stock till next 6 months. During the same month they sold a commodity B purchased from agriculturist amounting to ` 200000 and collected tax of ` 8,000

Now consider this situation in the pre- VAT era M/s Mohan and company has to deposit a tax of ` 8,000 to the Govt. though it has stock of tax paid goods, which have suffered a tax of ` 12,500.

But in a VAT era, there is a comfortable situation for M/s Mohan and company because due to its input credit of ` 12,500 no tax will be required to be paid for their output tax liability of ` 8000. The simple principal is there Tax paid on commodity A can be adjusted against the Tax due on commodity B and while final payment of tax whole the input tax credit is considered without differentiating between the goods sold and remained in stock. This particular benefit is the result of inbuilt system of VAT. Manufacturers stocking the raw material will be the biggest beneficiaries of this provision.

Certain industries have to stock raw material in a certain period for the whole year because of seasonal availability or because of favorable price. Suppose M/s XZY Mfg. and trading company has purchased raw material worth ` 50 Lakh after paying of ` 2 Lakh. In traditional sales tax system it had to pay regular sales tax on the sale of finished goods but under VAT during the first some months its tax liability will be very low or Zero due to the adjustment of Tax paid on its purchases.

TAX RATES UNDER VAT

The rates under VAT are minimum in numbers as suggested by the White paper as mentioned above and these rates are: -

Exempt or Tax Free.

1 *Per cent.*

4 Per cent.

12.5 *Per cent*.

All these four rates i.e. from Exempt to 12.5% were suggested by the White paper but most of the states have invented a new rate i.e. 20% to tax some of commodities to balance their revenue and local needs.

TIN- TAX IDENTIFICATION NUMBER

TIN is the unique Tax identification Number issued to every dealer registered under the VAT and it is 11 digits number in which first 2 digits represents the state in which the dealer is registered and rest of 9 digits set as per the local situations of the state. A dealer is recognised by his TIN.

COMPOSITION SCHEMES UNDER VAT

For dealers dealing directly with the consumers, composition scheme of paying composition amount in lieu of the tax, ranging from 0.25% to 1% is introduced by almost all the VAT states. The general upper limit for the Composition dealers is ` 50 Lakhs. The dealers opting for this scheme are not able to claim or pass on any input credit (ICT) hence practically they can sell goods to consumers only and re-sellers or non-consumers are not purchasing goods from them. Before opting for the composition scheme a cost benefit analysis is must to ascertain its feasibility.

The maximum rate of composition in lieu of tax is 1% but some of the states have introduced a much lower rate but in any case cost benefit analysis is necessary for opting for composition scheme.

Further the dealers under Composition scheme are not eligible for CST purchase i.e. they cannot purchase goods from other states and CST sales i.e. cannot sale goods to other states.

The procedure for composition dealer is very simple and they have to file very simple return. This is purely an optional scheme.

Restrictions on dealer eligible to opt for composition scheme.

Following dealers are not eligible for VAT composition scheme:-

1. Manufacturers.
2. Importers of Goods from outside the state.
3. Importers of Goods from outside India.
4. Dealers who are selling the goods in interstate trader or commerce.
5. Dealers who are purchasing the goods from unregistered dealers of the state.

Further it should be noted the purchases of Composition dealers should be from the VAT registered dealers of the State.

The composition dealers are saved from the complication of VAT i.e. they need not to calculate the input credit, need not to maintain complicated VAT records and also have to file a simple return and further required to pay a very small tax on their turnover and the turnover limit for them is ` 50 Lakhs. Further they have to purchases and sale all the goods from inside the state and all their purchases should be from registered dealers of their own state.

Features of Composition Scheme

1. The Composition dealers cannot take the credit of tax paid by them.
2. The composition amount cannot be charged in the bill.
3. The purchasers cannot claim the credit of tax on purchases from composition dealers.

Since the composition dealers cannot take the credit of the tax paid and further the composition dealers cannot charge the composition amount in their bill in that case it is a charge against their profit. Hence before going for the composition scheme they have to do cost benefit analysis.

Further the purchaser cannot claim the credit of tax with reference to the purchases from composition dealers. This is the biggest drawback. See composition dealers purchases goods within the state by paying state Vat and if they cannot pass the credit to their purchasers then the chain of VAT dealers is broken and the goods become taxable at full rate again. So no dealer or manufacturer purchases goods from the composition dealers and they can only sale the goods to the final consumers who do not need the input credit.

Threshold limit for VAT

One more point. There is a threshold limit also i.e. the limit up to which no tax is required to be paid by the dealers and further they do not required the registration also. The white paper has fixed the limit at ` 5 lakhs and also give states the power to increase the limit up to ` 10 Lakhs.