

VAT – Concepts and General Principles

Question 1

Briefly answer the following questions:-

- (a) Which is the most popular and common method for computing VAT liability and at what stage is the tax imposed?*
- (b) Is it correct to state that VAT usually increases the retail price, as the tax is payable on the first sale price?*
- (c) Can it be said that VAT brings about certainty to a great extent in the matter of interpretational issues? If so, how?*
- (d) Can VAT be said to be non-beneficial as compared to single stage-last point system?*
- (e) Briefly explain the income variant of VAT.*
- (f) What is the demerit of VAT from the view point that it is a form of consumption tax?*
- (g) Discuss the word “transparency” in the context of VAT system.*
- (h) What are the items aggregated in the addition method to calculate the VAT payable? When is this method mainly used?*

Answer

- (a)** Invoice method is the most common and popular method for computing the tax liability under the VAT system. Under this method, tax is imposed at each and every stage of sales on the entire sale value, and the tax paid at the earlier stage is allowed as set-off.
- (b)** The statement is not correct as VAT is a multi-point tax where tax is imposed at each and every stage of sales and tax paid at the earlier stage is allowed as set-off.
- (c)** 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)** VAT system has many advantages like no tax evasion, transparency, certainty, reduction in cascading effect of taxes etc. However, since the VAT is imposed or paid at various stages and not at last stage, it increases the working capital requirements and the interest burden on the same. In this way, it may be considered to be non-beneficial as

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compared to the single stage-last point taxation system though to a certain extent, this rigour can be brought down through input credits on purchases.

- (e) The income variant of VAT allows for deductions of 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.
- (f) 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.

- (g) Out of total consideration paid for purchase of material, the buyer knows the tax component under a VAT system. Thus, the system ensures transparency. This transparency enables the State Government 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 regards to rate of tax etc.
- (h) In the addition method,
 - (i) All the factor payments, and
 - (ii) Profit, are added to arrive at the value addition on which VAT rate is applied to compute the VAT payable.

This method is mainly used with income variant of VAT.

Question 2

Answer the following:

- (a) *Briefly explain the invoice method of computing tax liability under the VAT system. What are its other names?*
- (b) *What are the different variants of VAT and how is deduction available for tax paid on inputs including capital inputs?*
- (c) *Briefly explain how VAT helps in checking tax evasion and in achieving neutrality.*
- (d) *How can an auditor play a role to ensure that the tax payers discharge their tax liability properly under the VAT system?*
- (e) *Discuss the 'subtraction method' for computation of VAT.*
- (f) *VAT would increase the working capital requirements and the interest burden. Discuss*

Answer

- (a) Invoice method 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 the VAT law as introduced in several States and Central Excise Law, this method is followed.

This method is also called the 'Tax Credit Method' or 'Voucher Method'.

- (b) There are three variants of VAT viz, gross product variant, income variant and consumption variant.

Gross Product Variant: Under this variant, deduction is allowed for tax paid on all inputs excluding capital inputs.

Income Variant: Under this variant, tax paid on non-capital inputs and depreciation on capital inputs is allowed.

Consumption variant: Under this variant, deduction is allowed for tax paid on all business inputs including capital inputs.

- (c) 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.

Further, 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 organisation. 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. In short, the allocation of resources is left to be decided by the free play of market forces and competition.

- (d) Under the VAT system, trust has been reposed on tax payers, as there will be no regular assessment of all VAT returns, but only a few VAT returns will be taken up for scrutiny assessment. In other cases, the return filed by the trader will be accepted. It will not be also seen whether proper records have been maintained by the trader.

As a consequence, a check on compliance becomes essential. Chartered Accountants can ensure tax compliance by:-

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- (i) helping the client in systematic record keeping;
 - (ii) helping the client in interpretation of the provisions of VAT law, and
 - (iii) performing audit of VAT accounts.
 - (iv) reporting the under-assessment, if any, made by the dealer requiring additional payment or
 - (v) reporting any excess payment of tax warranting refund to the tax payers.
- (e) Under the subtraction method, the tax is charged only on the value added at each stage of the sale of the 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.
- (f) One of the demerits of VAT is that it increases the working capital requirements and the interest burden. The tax is imposed or paid at various stages and not on last stage only. It increases the requirement of working capital and also the interest element as compared to single stage-last point taxation system.

Question 3

Compute the invoice value to be charged and amount of tax payable under VAT by a dealer who had purchased goods for ₹ 1,20,000. He incurred expenses of ₹ 10,000 and added a profit ₹ 15,000 while selling the same.

The rate of VAT on purchases and sales is 12.5%.

Answer

Computation of invoice value:-

Particulars	₹	₹
Cost of goods purchased		1,20,000
Add: Expenses	10,000	
Add: Profit margin	<u>15,000</u>	<u>25,000</u>
Product Sale Value		1,45,000
Add: VAT @ 12.5%		<u>18,125</u>
Invoice Value		1,63,125
Computation of amount of tax payable under VAT		
VAT charged on sales		18,125
Less: Input credit of VAT paid on purchases @ 12.5% on 1,20,000		<u>15,000</u>
Tax Payable under VAT		<u>3,125</u>

Note: It has been assumed that the purchase price of ₹ 1,20,000 is exclusive of VAT.

Question 4

Compute the VAT amount payable by Mr. A who purchases goods from a manufacturer on payment of ₹ 2,25,000 (including VAT) and earns 10% profit on sale to retailers. VAT rate on purchase and sale is 12.5%.

Answer

Computation of VAT payable by Mr. A:-

	Amount (₹)
Payment made to manufacturer	2,25,000
Less: VAT paid $(2,25,000 \times 12.5)/112.5$	25,000
Purchase price	2,00,000
Add: Profit margin (10% of Cost Price)	20,000
Sale price before VAT	2,20,000
Add: VAT @ 12.5% on ₹ 2,20,000	27,500
Invoice value after 10% profit margin	2,47,500
VAT charged in invoice	27,500
Less: VAT input credit $(2,25,000 \times 12.5)/112.5$	25,000
VAT payable by Mr. A	2,500

Note: Profit has been computed as 10% of the cost price of the goods.

Question 5

Mr. Goenka is a trader selling raw materials to a manufacturer of finished products. He imports his stock in trade as well as purchases the same from the local markets. Following transaction took place during financial year 2011-12:-

Calculate the VAT and invoice value charged by him to a manufacturer. Assume the rate of VAT @ 12.50%:

		₹
(1)	Cost of imported materials (from other State) excluding tax	1,00,000
(2)	Cost of local materials including VAT	2,25,000
(3)	Other expenditure including storage, transport, interest and loading and unloading and profit earned by him	87,500

Answer

Computation of VAT and invoice value:-

Particulars	₹
Imported material cost	1,00,000

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[Since, this is not a VAT levied inside the State, it will form part of cost of input]	12,500
Add: Cost of local materials	2,25,000
Less: VAT @12.5%	<u>25,000</u>
[Since, credit of ₹ 25,000 would be available, it will not be included in cost of input]	2,00,000
Add: Other expenses and profit	<u>87,500</u>
Sales Price of goods	4,00,000
Add: VAT on the above @12.5%	<u>50,000</u>
Invoice value charged by Mr. Goenka to the manufacturer	4,50,000

VAT charged by Mr. Goenka is ₹ 50,000.

Question 6

What are the merits of VAT in the context of tax evasion, neutrality and transparency?

Answer

- (1) **No tax evasion:** - 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.
- (2) **Neutrality:** - The greatest advantage of VAT 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.
- (3) **Transparency:** - Under VAT system, the buyer knows the tax component out of the total consideration paid for purchase of material. Thus, the system ensures transparency also.

Question 7

Mr. X, a manufacturer sells goods to Mr. B, a distributor for ₹ 2,000 (excluding VAT). Mr. B sells goods to Mr. K, a wholesale dealer for ₹ 2,400. The wholesale dealer sells the goods to a retailer for ₹ 3,000, who ultimately sells to the consumers for ₹ 4,000.

Compute the tax liability, input credit availed and tax payable by the manufacturer, distributor, wholesale dealer and retailer under invoice method assuming VAT rate @ 12.5%.

Answer**Computation of tax liability, input tax credit availed and tax payable under invoice method**

Stage	Particulars	VAT Liability	Less VAT Credit	Tax payable to Government
1.	X, the manufacturer, sells to B, the distributor, for ₹ 2,000. Therefore his tax liability will be ₹ 250 (₹ 2,000 @ 12.5%). He will not have any VAT credit.	250	-	250
2.	B, the distributor, sells goods to K, the wholesale dealer, for ₹ 2,400. B's tax liability will be ₹ 300 (₹ 2,400 @ 12.5%). He will get set off of tax paid at earlier stage of ₹ 250. Thus, tax payable by him will be ₹ 50.	300	250	50
3.	K, the wholesaler dealer, sells to retailer at ₹ 3,000. K's tax liability will be ₹ 375 (₹ 3,000 @ 12.5%). He will get set off of tax paid at earlier stage of ₹ 300. Thus, tax payable by him will be ₹ 75.	375	300	75
4.	Retailer sells goods to consumers at ₹ 4,000. His tax liability will be ₹ 500 (₹ 4,000 @ 12.5%). He will get set off of tax paid at earlier stage of ₹ 375. Thus, tax payable by him will be ₹ 125/-	500	375	125

Note: It has been assumed that sales made by the distributor, the wholesale dealer and the retailer are also exclusive of VAT.

Question 8

Mr. Rajesh is a registered dealer and gives the following information. You are required to compute the net tax liability and total sales value under value added tax:

Rajesh sells his products to dealers in his State and in other States.

The profit margin is 15% of cost of production and VAT rate is 12.5% of sales.

(i) Intra State purchases of raw material ₹ 2,50,000/- (excluding VAT @ 4%)

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- (ii) Purchases of raw materials from an unregistered dealer ₹ 80,000/- (including VAT @ 12.5%)
- (iii) High seas purchases of raw materials are ₹ 1,85,000/- (excluding custom duty @ 10% of ₹ 18,500)
- (iv) Purchases of raw materials from other States (excluding CST @ 2%) ₹ 50,000/-
- (v) Transportation charges, wages and other manufacturing expenses excluding tax ₹ 1,45,000/-
- (vi) Interest paid on bank loan ₹ 70,000/-

Answer

Computation of net VAT liability and total sales value

	₹
Intra-State purchases of raw material (excluding VAT ₹ 10,000)	2,50,000
Purchases of raw materials from unregistered dealer [Refer Note 1]	80,000
High seas purchases of raw materials [Refer Note 2]	2,03,500
Purchase of raw materials from other States [Refer Note 3]	51,000
Transportation charges, wages and manufacturing expenses	<u>1,45,000</u>
Cost of production	7,29,500
Add : Profit margin 15%	<u>1,09,425</u>
	8,38,925
Add: VAT @ 12.5%	<u>1,04,866</u>
Total sales value	<u>9,43,791</u>

Computation of VAT liability:-	₹	₹
VAT on above sales price @ 12.5%		1,04,866
Less: Set off of VAT on purchases:		
From high seas	Nil	
From intra-State [Refer Note 4]	10,000	
From inter-State	Nil	
From unregistered dealer	Nil	<u>10,000</u>
Net VAT payable		<u>94,866</u>

Notes:

- Input tax credit is not available on the purchases of raw materials from unregistered dealer. Hence, VAT paid thereon is a part of cost of production.
- Duty paid on high seas purchases i.e., imports is not a State VAT, so the input tax credit is not available in respect of the same and it is a part of cost of production.

3. Set-off of tax paid on inter-state purchases is not allowed.
4. Tax on intra-State purchases is ₹ 10,000. As credit of the same will be available, it is not included in the cost of production.
5. Interest on loan has been excluded for calculating the cost of production on the presumption that the loan is availed for purposes other than working capital.
6. It has been assumed that the entire production is sold.

Question 9

State the variants of VAT. Present them in schematic diagram and explain each one briefly.

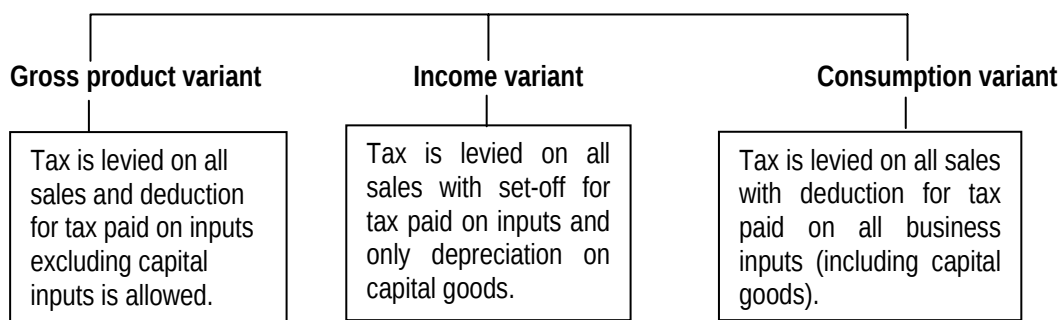
Answer

VAT has following three variants:

- (a) Gross product variant
- (b) Income variant
- (c) Consumption variant

These variants are presented in a schematic diagram given below:

Different variants of VAT



- (a) **Gross product variant:** 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.
- (b) **Income variant:** 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

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of any method of measuring depreciation, which basically depends on the life of an asset as well as on the rate of inflation.

- (c) **Consumption variant:** 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.

Question 10

Compute the VAT payable by Mr. Shyam, who purchased goods from a manufacturer on payment of ₹ 4,16,000 (including VAT) and earned 20% profit on purchase price. VAT rate on both purchases and sales is 4%.

Answer

Computation of VAT payable by Mr. Shyam

	₹
Payment made to manufacturer	4,16,000
Less: VAT paid $[(4,16,000/104) \times 4]$	<u>16,000</u>
Purchase price	4,00,000
Add: Profit margin @ 20% on purchase price	<u>80,000</u>
Sale price before VAT	4,80,000
VAT @ 4% on ₹ 4,80,000	19,200
Less: Input credit	<u>16,000</u>
VAT payable by Mr. Shyam	3,200

Question 11

The following are details of purchases, sales, etc. effected by Vasudha & Co., a registered dealer, for the year ended 31.3.2012 :

Particulars	Amount (₹)
Purchase of raw materials within State, 1000 units, inclusive of VAT levy at 6%	5,30,000
Inter-State purchases of raw materials, inclusive of CST at 2%	2,04,000
Import of raw materials, inclusive of customs duty of ₹ 35,000	4,35,000
Capital goods purchased on 1.5.2011, inclusive of VAT levy at 10% (input credit to be spread over 2 financial years)	3,30,000
Other manufacturing Expenses	1,50,000
Sale of taxable goods within State, inclusive of VAT levy at 4%	7,28,000

Sale of goods within State, exempt from levy of VAT (Goods were manufactured from the Inter-State purchase of raw materials)	1,20,000
Closing stock as on 31.3.2012 was 100 units of raw materials purchased within the State	

Input credit is allowed only on raw materials used in manufacture of the taxable goods. Compute the VAT liability of the dealer for the year ended 31.3.2012.

Answer

Computation of VAT liability of Vasudha & Co. for the year ended 31.3.2012:-

Particulars	Amount (₹)
Input tax credit:	
Intra-State purchases of 1000 units raw materials [Refer Note 1]	30,000
Inter-State purchases of raw materials [Refer Note 2]	-
Import of raw materials [Refer Note 3]	
Purchase of Capital Goods [Refer Note 4]	15,000
Other manufacturing expenses [Refer Note 5]	
Total input tax credit available (A):	<u>45,000</u>
Output VAT payable:	
Sale of taxable goods within State [(7,28,000 × 4)/104]	28,000
Sale of exempted goods within State [Refer Note 6]	-
Total VAT payable (B)	<u>28,000</u>
Net VAT liability (VAT credit to be carried forward) [(B)-(A)]	<u>(17,000)</u>

Notes:-

- VAT paid on intra-State purchases is eligible for input tax credit $\left[\frac{5,30,000 \times 6}{106} \right]$.
- CST paid on intra-State purchases is not eligible for input tax credit.
- Customs duty is not eligible for input tax credit.
- VAT paid on purchase of capital goods is eligible for input tax credit. However, the same has to be spread over a period of two years $\left[\frac{3,30,000 \times 10}{110 \times 2} \right]$.
- No input tax credit can be availed on expenses incurred on manufacturing.

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6. No VAT will be payable on sale of goods exempted from levy of VAT. Further, since these goods were manufactured from the inter-State purchases of raw materials (non-vatable inputs), input tax credit is not affected.
7. VAT system allows credit in respect of purchases made during a period to be set-off against the taxable sales during that period, irrespective of when the supplies/inputs purchased are utilized/sold. Therefore, input tax credit in respect of closing stock of raw materials need not be reduced from total input tax credit available.

Note: The statement in the question, "Input credit is allowed only on raw materials used in manufacture of the taxable goods", implies that the same is not allowable in respect of sale of goods within the State which are exempt from levy of VAT.

Question 12

Which variant of VAT is most widely used in the world and why? Are some services also included in the VAT net by such countries?

Answer

Among the three variants of VAT, the consumption variant is widely used. Several countries of Europe and other countries 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.

Question 13

What are the major deficiencies of VAT system in India ?

Answer

The major deficiencies of VAT system in India are as under:

- (1) There is lack of uniformity in the rates of VAT in different States. Distortion occurs on account of different rates of VAT, composition Scheme, exemptions, difference in classification of goods, etc.

- (2) Central Sales Tax is not integrated with the State VAT. Therefore, it is difficult to put the purchases from other States at par with the purchases within the State. Consequently, the advantage of neutrality is confined only for purchases within the State.
- (3) For complying with the VAT provisions, the accounting cost has increased which may not be commensurate with the benefit to traders and small firms.
- (4) VAT is paid at various stages and not at last stage. This has increased the requirement of working capital and the interest burden on the same.
- (5) VAT, being a consumption tax, tends to be regressive since the proportion of income spent on consumption is large for the poor than the rich.
- (6) As a result of introduction of VAT, the administrative cost to the States has increased on account of number of dealers going up significantly.

Question 14

How can a Chartered Accountant help a client in the handling of VAT audit called for by the Department and in conducting external audit of VAT records?

Answer*Handling audit by Departmental Auditors*

There are audit wings in VAT Departments and certain percentage of dealers are taken up for audit every year on scientific basis. Chartered Accountants can ensure proper record keeping 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.

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, returns filed by dealers 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.

Question 15

Explain the role of Chartered Accountants in proper compliance of VAT.

Answer**A Chartered Accountant plays a key role in proper compliance of VAT:-**

- (i) *Record keeping:* For effective utilization of input tax credit, systematic records of the same have to be maintained. Chartered Accountants are well-equipped to ensure compliance of such record keeping requirements prescribed under VAT laws of different States.

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- (ii) *Handling audit by Departmental officers:* By maintaining proper records of the client, a Chartered Accountant is able to satisfy the Departmental auditors. His professional expertise helps him in effectively replying to audit queries and resolving audit objections.
- (iii) *Procedural requirements of VAT laws:* Chartered Accountants ensure compliance of various procedural requirements prescribed under VAT laws of different States like submission of periodical returns, statements etc. by utilizing their technical knowledge and analytical abilities.
- (iv) *External audit of VAT records:* Under VAT, assessee is required to self-assess the VAT liability and only a few returns would be scrutinized on a selective basis. Hence, a check on compliance gains paramount importance. Chartered Accountants help in ensuring tax compliance by audit of VAT accounts.

Question 16

Ashok, purchased raw material 'A' for ₹ 30,00,000 plus VAT @ 4%. Out of such raw material 60% was used for manufacture of taxable goods and the remaining for manufacture of goods which are exempt from VAT.

Another raw material 'B' was purchased for ₹ 15,00,000 on which VAT was paid at 1 %. Entire raw material 'B' was used for manufacture of taxable goods only.

The entire taxable goods were sold for ₹ 50,00,000 plus VAT @ 12.5%.

Compute VAT liability of Ashok on the assumption that there was no opening or closing inventory.

Note: Ashok is not a dealer who opted for Composition Scheme.

Answer

Computation of VAT liability of Ashok

Particulars	₹	₹
Output VAT (50,00,000 × 12.5%) [A]		6,25,000
Input VAT [B]		
Raw material 'A' (30,00,000 × 60% × 4%) [Refer Note 1]	72,000	
Raw material 'B' (15,00,000 × 1%)	<u>15,000</u>	<u>87,000</u>
Net VAT payable by Ashok [A] – [B]		<u>5,38,000</u>

Note: Input tax credit is allowed only in respect of the raw material used in manufacture of taxable goods and hence, the same is restricted to the extent of 60%.

Question 17

X Co. furnishes you the following information:

Raw material purchased ₹ 5,00,000 plus VAT @4%.

Manufacturing expenses (revenue nature) ₹2,00,000.

Sale price ₹8,00,000 plus VAT @ 4%.

Plant & machinery acquired ₹2,50,000 plus VAT @ 4% eligible for input tax credit in the year of acquisition itself.

Compute VAT liability under :

- (i) gross product variant.
- (ii) consumption variant.

State which variant is beneficial to the dealer?

Answer

Under gross product variant of VAT, deduction for taxes on all purchases of raw materials and components is allowed. However, deduction for tax paid on capital goods is not allowed. Hence, the VAT liability under gross product variant would be calculated as under:

Computation of VAT liability under Gross Product Variant

Particulars	₹
VAT payable on sales (8,00,000 × 4%)	32,000
Less: Input VAT allowed on raw material (5,00,000 × 4%)	<u>20,000</u>
Net VAT payable	12,000

Under consumption variant of VAT, deduction for taxes paid on all business purchases including capital goods is allowed. Hence, VAT liability under consumption variant would be calculated as under:

Computation of VAT liability under Consumption Variant

Particulars	₹	₹
VAT payable on sales (8,00,000 × 4%)		32,000
Less: Input VAT allowed on raw material (5,00,000 × 4%)	20,000	
Input VAT allowed on capital goods (2,50,000 × 4%) (whole input tax credit is allowed in the year of acquisition itself)	<u>10,000</u>	30,000
Net VAT payable		<u>2,000</u>

Since, the net VAT liability under consumption variant is less than the VAT liability under gross product variant, consumption variant is beneficial to the dealer.

Question 18

Explain the consumption variant of VAT. Mention the reasons for the preference of this variant of VAT.

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Answer

Under consumption variant of VAT, tax is levied on all sales and deduction for taxes paid on all business purchases including capital goods is allowed. There is neither any differentiation between capital and revenue expenditures nor the life of assets or depreciation allowances for different assets is specified. This variant is indifferent to the methods of production employed by the manufacturer. Decision to save or consume does not make any difference under this variant.

Among the three variants of VAT, the consumption variant is widely used. The reasons for its preference over other variants are as follows:-

- (i) Consumption variant does not affect decisions regarding investment because the tax on capital goods is also set off against the VAT liability. Hence, usage of labour or capital intensive technique of production does not make any difference from taxation point of view.
- (ii) Consumption variant is convenient from administrative expediency as it simplifies tax administration by removing the need to distinguish between purchases of intermediate and capital goods on one hand and consumption goods on the other hand.
- (iii) Most of the countries include services in their tax base and hence prefer consumption variant over other variants as the business gets set off for the tax on services thereby removing the cascading effect.

Question 19

Determine the liability of VAT of X for the month of December 2012 using invoice method of computation from the following data:

Purchase price of goods acquired from local market (including VAT)	₹ 52 lakhs
VAT rate on input	4%
Transportation, insurance, warehousing and handling cost incurred by X	₹ 20,000
Goods sold at a profit margin	14%
VAT rate on sales	12.50%

Answer

Computation of VAT liability

Particulars	₹
Purchase price of goods acquired from local market excluding VAT (input tax credit does not form part of cost of production)	50,00,000
$\text{₹} \left[52,00,000 \times \frac{100}{104} \right]$	

Transportation, insurance etc.	20,000
Cost of production	50,20,000
Profit @ 14% on cost of production [assumed to be a percentage of cost of production]	7,02,800
Total Sales	57,22,800
Output VAT payable @ 12.5%	7,15,350
Less: Input tax credit [VAT paid on goods acquired from local market is eligible for input tax credit]	2,00,000
Net VAT payable	5,15,350

Question 20

What are the different variants of VAT and how is deduction available for tax paid on inputs including capital inputs?

Answer

The different variants of VAT are:-

1. *Gross product variant:* Under gross product variant, deduction for taxes on all inputs is allowed, but not for tax paid on capital goods.
2. *Income variant:* Under income variant, deductions for tax paid on inputs and depreciation on capital goods is allowed.
3. *Consumption variant:* Under consumption variant, deduction for taxes paid on all business inputs including capital goods is allowed.

Question 21

What are the different stages of VAT? Can it be said that the entire burden falls on the final consumer?

Answer

VAT is levied at each stage of production and distribution on the value added at the respective stage. Value added is the difference between the sales price and purchase price or the sum of wages, interest and other costs incurred and profits.

Broadly, VAT is paid at each of the following stages of a sale transaction:-

Manufacturer $\Rightarrow$ Wholesaler $\Rightarrow$ Retailer $\Rightarrow$ Consumer

Yes, entire burden of VAT falls on the final consumer and he does not get any credit of the same.

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Question 22

Ms. Pragma, a dealer submits the following information. Compute the net VAT liability from the following information:

Particulars	₹
Import of raw material (including 10% import duty)	1,10,000
Raw material purchased from Kerala. (including excise duty @ 12%)	2,24,000
VAT @ 4% on the above purchase	
Raw material purchased from Karnataka	85,000
Transportation and manufacturing expenses	47,000

Pragma sold entire stock to Nishu at a profit of 10% on the cost of production. VAT rate on such sale is 4%.

Answer

Computation of net VAT liability

Particulars	₹
Import of raw material [Refer Note 1]	1,10,000
Raw material purchased from Kerala [Refer Note 2]	2,24,000
Raw material purchased from Karnataka [Refer Note 3]	85,000
Transportation and manufacturing expenses	<u>47,000</u>
Cost of production	4,66,000
Add : Profit margin @10%	<u>46,600</u>
Sales value	<u>5,12,600</u>
Output VAT payable @ 4%	20,504
Less: Input tax credit (₹2,24,000 x 4%) – [Refer Note 1, 2 and 3]	<u>8,960</u>
Net VAT liability	<u>11,544</u>

Notes:

- (1) Import duty is not eligible for input tax credit. Hence, it will form part of cost of production.
- (2) VAT paid on intra-state purchases is eligible for input tax credit and hence, it does not form part of cost of production.
- (3) It has been assumed that value for raw material purchased from Karnataka is inclusive of CST. CST paid on inter-state purchases is not eligible for input tax credit and thus, it forms part of cost of production.

Question 23

"The basic simplification of VAT is with reference to assessment". Discuss briefly

Answer

The basic simplification of VAT is with reference to assessment as 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 upon setting off the tax credit, return forms etc. 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.

Question 24

How can an auditor play a role to ensure that the tax payers discharge their tax liability properly under the VAT system?

Answer

Under the VAT system, trust has been reposed on tax payers, as there will be no regular assessment of all VAT returns, but only a few VAT returns will be taken up for scrutiny assessment. In other cases, the return filed by the trader will be accepted. It will not be also seen whether proper records have been maintained by the trader.

As a consequence, a check on compliance becomes essential. Chartered Accountants can ensure tax compliance by:-

- (i) helping the client in systematic record keeping;
- (ii) helping the client in interpretation of the provisions of VAT law, and
- (iii) performing audit of VAT accounts.
- (iv) reporting the under-assessment, if any, made by the dealer requiring additional payment or
- (v) reporting any excess payment of tax warranting refund to the tax payers.

Question 25

Under VAT, the allocation of resources is left to be decided by the free play of market forces and competition. Discuss the validity of the statement.

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Answer

Yes, the statement is absolutely valid. The greatest advantage of VAT 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 organisation. 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. In short, the allocation of resources is left to be decided by the free play of market forces and competition.

Question 26

Dev Dealers furnished the following details for the financial year 2012-13:-

<i>Inputs purchased within the State</i>	<i>₹ 1,00,000</i>
<i>Finished goods sold within the State</i>	<i>₹ 2,00,000</i>
<i>Goods sold in the course of inter-State trade</i>	<i>₹ 1,00,000</i>
<i>Capital goods procured during the month</i>	<i>₹ 1,00,000</i>
<i>VAT paid on capital goods</i>	<i>12.5%</i>
<i>Input VAT rate</i>	<i>12.5%</i>
<i>Output VAT rate</i>	<i>4%</i>
<i>Central sales tax rate</i>	<i>2%</i>

Compute the total tax liability under the State VAT law and under the Central Sales Tax Act.

Note: The capital goods are not the goods included in the negative list.

Answer

Computation of the tax liability for the financial year 2012-13:-

	₹
Inputs purchased in the month	1,00,000
Output sold in the month (within the State)	2,00,000
Inter-State sales	1,00,000
Input credit (including capital goods) (₹ 12,500 + ₹ 12,500)	25,000
Output tax	8,000
CST for Inter-State sale	2,000
State VAT liability (₹ 8,000 – ₹ 25,000)	Nil
Excess credit	17,000
Central sales tax to be paid (₹ 2,000 – ₹ 17,000)	Nil
Excess credit carried forward to subsequent period	15,000

Question 27

Can VAT be said to be non-beneficial as compared to single stage-last point system?

Answer

VAT system has many advantages like no tax evasion, transparency, certainty, reduction in cascading effect of taxes etc. However, since the VAT is imposed or paid at various stages and not at last stage, it increases the working capital requirements and the interest burden on the same. In this way, it may be considered to be non-beneficial as compared to the single stage-last point taxation system though to a certain extent, this rigour can be brought down through input credits on purchases.

Question 28

Mr. Ram, a dealer in Tamil Nadu dealing in consumer goods, submits the following information pertaining to the month of October, 2012:

Details of purchases of goods:-

Particulars (raw material purchased from within the State)	Amount (₹)	Rate of VAT
Goods 'A'	10,00,000	Exempt
Goods 'B'	20,00,000	1%
Goods 'C'	30,00,000	12.5%

Details of sales of goods:-

Particulars (Sale of finished goods)	State in which goods are sold	Amount (₹)	Rate of VAT
Produced from Goods 'A'	Tamil Nadu	5,00,000	12.5%
	Gujarat	7,00,000	1%
Produced from Goods 'B'	Tamil Nadu	24,00,000	Exempt
Produced from Goods 'C'	Tamil Nadu	35,00,000	4%

Compute the amount of Value Added Tax (VAT) payable by Mr. Ram for the relevant month. There was no opening or closing inventory.

Answer

Computation of VAT payable by Mr. Ram for the month of October, 2012:-

	Particulars	₹
(A)	Output tax payable	
	(i) On sale of finished goods produced from Goods 'A' within the State (₹ 5,00,000 × 12.5%)	62,500

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	(ii) On taxable sale of finished goods produced from Goods 'C' within the State ($\text{₹ } 35,00,000 \times 4\%$)	<u>1,40,000</u>
	Total (A)	<u>2,02,500</u>
(B)	Input tax credit available	
	(i) Goods 'A' (Exempt)	Nil
	(ii) Goods 'B' (Note-1)	Nil
	(iii) Goods 'C' ($\text{₹ } 30,00,000 \times 12.5\%$)	<u>3,75,000</u>
	Total (B)	<u>3,75,000</u>
	Net VAT payable = (A)-(B)	(1,72,500)
	CST payable on inter-state sale of goods produced from Goods 'A' ($\text{₹ } 7,00,000 \times 1\%$) shall be paid from the balance of credit of ₹ 1,72,500.	<u>7,000</u>
	Balance of input credit carried forward to next month	<u>1,65,500</u>

Notes:

- Since, there is no opening and closing inventory, it implies that entire purchase of the Goods 'B' is used to manufacture the finished goods (which are exempt from tax). Further, purchases of goods, which are being utilized in the manufacture of exempted goods, are not eligible for input tax credit. Hence, no input tax credit is available in respect of VAT paid on purchase of Goods 'B'.
- If finished goods are sold in the course of inter-state trade and commerce, credit is allowed.

Question 29

A manufacturer sold goods to distributor for ₹ 20,000. The distributor sold the goods to the wholesaler for ₹ 24,000. The wholesaler sold the goods to the retailer for ₹ 30,000. The retailer sold the goods to the final consumer for ₹ 40,000. The VAT rate is 12.5% which is charged separately.

Compute VAT liability under Invoice method. State, why this method is preferable.

Answer

Computation of VAT liability under invoice method

Particulars	VAT liability ₹	Less VAT credit ₹	Tax to Government ₹
Manufacturer sells the goods to distributor. ₹ 20,000 $\times$ 12.5%	2,500	--	2,500
Distributor sells the goods to wholesaler.	3,000	2,500	500

₹ 24,000 x 12.5%			
Wholesaler sells the goods to a retailer.	3,750	3,000	750
₹ 30,000 x 12.5%			
Retailer sold the goods to consumer.	5,000	3,750	1,250
₹ 40,000 x 12.5%	<u> </u>	<u> </u>	<u> </u>
Total	14,250	9,250	5,000

This method is preferable as the tax is charged at each stage of sales on the entire sales value and the tax paid at the earlier stage is allowed as set off. In India, the VAT law as introduced in several States and under the Central Excise Law, this method is followed.

Question 30

Compute net VAT liability of Rishi from the following information:

Particulars	₹	₹
Raw materials from foreign market (includes duty paid on imports @ 20%)		1,20,000
Raw material purchased from local market		
Cost of raw material	2,50,000	
Add: Excise duty @ 12%	<u>30,000</u>	
	2,80,000	
Add: VAT @ 4%	<u>11,200</u>	2,91,200
Raw material purchased from neighbouring State (includes CST @ 2%)		51,000
Storage and transportation cost		9,000
Manufacturing expenses		30,000

Rishi sold goods to Madan and earned profit @ 12% on the cost of production. VAT rate on sale of such goods is 4%.

Answer

Computation of VAT liability of Rishi:-

Particulars	₹	₹
Raw materials purchased from foreign market (including duty paid on imports @ 20%)		1,20,000
Raw material purchased from local market:-		
Cost of raw material	2,50,000	

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Add: Excise duty @ 12%	<u>30,000</u>	2,80,000
Raw material purchased from neighbouring State (including CST @ 2%)		51,000
Storage and transportation cost		9,000
Manufacturing expenses		<u>30,000</u>
Cost of production		4,90,000
Add: Profit @ 12% of cost of production		<u>58,800</u>
Sale Price		<u>5,48,800</u>
VAT @ 4% on ₹ 5,48,800		21,952
Net VAT liability of Rishi:-		
VAT on sale price		21,952
Less: Input tax credit		
Duty paid on imports		Nil
CST paid on inter-state purchases		Nil
VAT paid on local purchases		<u>11,200</u>
Net VAT payable by Rishi		<u>10,752</u>

Question 31

List out the merits of VAT.

Answer

Merits of VAT

1. No tax evasion is possible as the credit of duty paid is allowed against the liability on the final product manufactured or sold. Under VAT, unless proper records are kept in respect of various inputs, it is not possible to claim credit. A perfect system of VAT is a perfect chain where tax evasion is difficult.
2. Neutrality is the greatest advantage of VAT. VAT does not interfere in the choice of decision for purchases because it has anti - cascading effect. The system is neutral with regard to choice of production technique, as well as business organisation. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase.
3. It has a certainty as it is based simply on transactions. 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.
4. Transparency is ensured as the buyer knows, out of the total amount paid for purchases of material, what is the amount paid towards VAT. 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.

5. For Government, better revenue collection and stability is achieved as 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.
6. Since the tax paid on an earlier stage is to be received back, the system promotes better accounting systems.

EXERCISES

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 ₹ 20,000 and pays VAT @12.50% i.e ₹ 2,500/. He also imports the material worth ₹10,000 on which he pays the duty of ₹ 1250. He can avail the input credit of:*
 - (a) *₹ 1250/*
 - (b) *₹ 2500/*
 - (c) *₹ 3750/*
 - (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*

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- (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.*
 9. *Briefly mention the contents of White Paper on State-Level VAT in India.*
 10. *Explain briefly the concept of central value added tax (CENVAT).*
 11. *What are the three variants of VAT? Explain briefly.*
 12. *Write a note on different methods of computation of VAT.*
 13. *Discuss the merits and demerits of VAT system.*
 14. *Discuss the role of Committee of State Finance Ministers in the implementation of State Level VAT in India.*
 15. *Discuss the role of Chartered Accountants in successful implementation of VAT.*

Answers

1. (b); 2. (b); 3. (a); 4. (d); 5. (c); 6. (b); 7. (a); 8.(b),(d)