

VAT in Special Transactions

Question 1

Explain how sales tax incentives cause problems for VAT system?

Answer

Traditionally, all the State Governments have been using sales-tax incentives as an important developmental tool particularly for industrial development of an area of the state which is either undeveloped or underdeveloped and where no one would like to set up an industry because of several disadvantages such as lack of proper infrastructure, remoteness of the market, unwillingness of the workers to work in the remote and isolated areas etc. The basic philosophy of the incentive schemes is that even if the State does not get revenue from sales tax, the taxpayer will contribute towards the development of the underdeveloped area of the State and get rewarded out of more realization.

Any fiscal exemption from tax or subsidy is against the principles of VAT as it breaks the VAT chain. VAT system works on the basis of tax credit passed at each stage of production and distribution through issuance of tax invoices. Dealers effecting exempted sales are not allowed to avail input tax credit and they cannot pass on the credit.

Question 2

Briefly explain different modes of incentives under VAT and their suitability for VAT regime.

Answer

Different modes of incentives under VAT are briefly described below:

- **Exemption from tax:** Under this mode incentives are given by way of exemption from tax. The eligible industry is not required to pay any sales tax on purchases of raw materials as well as on sales of finished product. The advantage of this mode is that the unit is not required to pay any tax and thus its realisation improves. This brings it in a position to stand the competition. The amount of exemption is to be availed within a specified period of time. The exemption so allowed ceases either with the expiry of exemption period or the exemption amount whichever occurs first.
- **Deferment of tax liability:** Under this mode eligible industry is at par with any other normal unit. It collects the tax on sale of finished goods and also pays the tax to its vendors on the purchases of raw materials etc. However, such eligible unit or industry is not required to pay the collected tax to the Government immediately. The tax liability is assessed by applying the normal provision. However, payment of tax to the Government

is deferred for particular period. Moreover, the liability is required to be paid in prescribed installments.

- **Remission of Tax:** Under this mode, an eligible industry is allowed to collect tax at an appropriate rate but is not required to pay the same. The unit is required to file periodical return and show the tax liability. The tax liability as per return is deemed to have been paid. The input tax paid on purchases by the unit is given as refund immediately after filing of return.

Comparative assessment of above three modes Under VAT Regime: Out of the above three modes, the exemption mode is not suitable for VAT Regime because it breaks the VAT chain. The dealers cannot issue tax invoices and pass on the credit. On the other hand, under Deferment Mode as well as Remission Mode, the VAT invoices showing VAT liability separately can be issued by the dealer which results in maintenance of VAT chain.

Question 3

Briefly describe the broad principles considered by the States while framing various sales-tax incentive schemes in VAT regime.

Answer

The broad principles considered by the States while framing various sales-tax incentive schemes in VAT regime are given below:

- (i) VAT chain should not be disturbed.
- (ii) There should not be any further revenue loss to the States.
- (iii) The Department should be able to track the transactions and should ensure that there is no evasion/avoidance of tax due to the policy.

Further, the States who have continued the old incentive schemes in the form of exemption/deferment considered the following additional issues:

- (i) the units enjoying exemption under the old law should not be put to disadvantageous position under the VAT system.
- (ii) the units purchasing inputs without payment of any tax should be allowed to enjoy the benefit under the new system also.

Question 4

Explain the guidelines to ascertain whether a transaction is a works contract.

Answer

To ascertain whether a transaction is a works contract as contemplated in Article 366(29A)(b) the following guidelines must be kept in view:

- ❖ There must exist an indivisible works contract. Divisible contracts are outside the scope.

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- ❖ Goods must be involved in the executions of works. Transfer of property in goods does qualify as works contract when it is incorporated in the works.
- ❖ Transfer of property in goods must pass as goods or in some other form. Form of goods has no relevance [It may be relevance for determination of rate of tax but not otherwise]
- ❖ Property in goods must pass during the execution of works and not before or after the execution of works.
- ❖ Some work has to be done on the property of the contractee by the contractor.
- ❖ In the works contract, transfer of property must be an integral part of its execution.
- ❖ Pure labour contracts or service contracts are outside the purview of the sales tax /VAT law.
- ❖ If during the execution of works contracts, goods are consumed and their identity is lost then no transfer of property occurs in those goods.
- ❖ There must be a dominant intention to effect the transfer of property in goods in execution of works contract. However, even if the dominant intention of the contract is rendering of a service and in that process if there is a transfer of property in goods, the contract will amount to a works contract.

Question 5

Write a brief note to explain the impact of VAT on lease transactions.

Answer

Impact of VAT on lease transactions:-

1. Lease is chargeable to tax by virtue of sub – clause (d) of clause 29A of Article 366 of the Constitution of India. This is a tax on the transfer of right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.
2. The taxable event is the transfer of right to use any goods and hence immovable property is not covered.
3. The taxable turnover means the valuable consideration paid or payable for any sale in a given period. Certain States have provided for deduction of interest or finance charges for the purpose of determination of taxable turnover.
4. Lease of an asset in the course of inter-State trade cannot be subject to VAT.
5. Transfer of right to use does not presuppose ownership of the goods. A sub-lease of an asset also is taxable unless specifically exempt under the State VAT Law.
6. Sale of leased asset after the end of the lease period is taxable as a normal sale.
7. The maintenance of leased asset involving supply of materials for maintenance/ repair by the lessor will not amount to a works contract as there would be no transfer of property in

such materials to the lessee. Hence, there would be no VAT on the value of materials supplied during maintenance/repair of the leased asset.

8. The assets given on lease will be generally capitalized by the lessor in his books and will be treated as capital assets. Thus, provision relating to input tax credit on capital goods will apply.
9. The lessor would pay VAT at the time of procurement of goods. However, liability to pay VAT on lease rentals will be spread over the tenure of the lease. Therefore, some States have provided for utilization of input credit for paying output tax only over the entire period of lease

Question 6

Explain the concept of Hire-purchase transactions. Comment upon their eligibility to VAT.

Answer

Concept of Hire-purchase Transactions: Under hire-purchase transactions, the hirer acquires the property (goods) immediately on signing the hire-purchase agreement but the ownership or title of the same is transferred only when the last installment is paid. The hire-purchase transactions are governed by Hire-Purchase Act, 1972. The aforementioned Act defines a hire-purchase as “an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which:

- (i) The owner delivers possession of goods to a person on condition that such person pays the agreed amount in periodic installments;
- (ii) The property in the goods is to pass to such person on the payment of the last of such installments; and
- (iii) Such person has a right to terminate the agreement at any time before the property so passes.”

Hire-purchase transactions and VAT: The definition of term “sale “ under VAT laws of various states provides that the taxable event will be the delivery of goods on hire-purchase or any system of payment by installments. It can be safely inferred that hire-purchase transactions are effected for monetary consideration. In case of hire-purchase, ownership of goods passes when the hirer exercises his option to purchase the goods subject to fulfillment of the terms of the agreement and then the transaction fructifies into a concluded (normal) sale. The important point to be noted in case of hire-purchase transaction is that taxable event is delivery of goods and not the completed sale on payment of the last installment. Resultantly, VAT is attracted on the delivery of goods.

Question 7

Explain briefly whether VAT is leviable on each of the following lease transactions:-

- (a) *Inter State Leasing*

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- (b) *Sale of leased asset after lease period*
- (c) *Maintenance of leased asset*

Answer

- (a) Lease of an asset in the course of inter-State or import trade cannot be taxed under a State VAT law. It can be taxed under the Central Sales-tax Act, 1956 as deemed sales.
- (b) Sale of a leased asset after the lease period is over is taxable in the same manner in which normal sale of such asset would have been taxed. Normally, such sale is effected to the same lessee and hence, such sale would be a local one exigible to tax under the VAT laws of the State in which the asset is located.
- (c) The maintenance of the leased asset involving supply of materials for maintenance/repair by the lessor would not amount to works contract, as there would be no transfer of property in such materials to the lessee. Thus, there would be no VAT on the value of the materials supplied during maintenance/repair of the asset. In case of computers, generally the lessor undertakes the maintenance and repair of the leased computers. However, the materials required during such maintenance /repair would be input for sale and input tax credit will be available.

Exercise

1. *What is the taxable turnover for works contract? Also mention the types of tax rates specified under various VAT laws.*
2. *What is a works contract? Is it a sale? Explain with reference to the constitutional authority providing for the same.*
3. *How can the input tax credit be claimed in case of lease transactions?*