

Value Added Tax

Introduction:

Value Added Tax (VAT) is consumption based tax. It is tax on Value Addition. The value added to the product is sale price charged to its customer minus cost of the material and other taxable inputs.

VAT is like sales tax to the extent that it is borne by the consumer. It differs from sales tax to the extent that in case of sales tax, tax is collected and remitted to government only once, at the point of purchase by the consumer. With VAT, collections, remittances to the government and credits for taxes already paid occur each time a business in the supply chain purchases a product.

VAT avoids cascading effect of tax by taxing only the value added at each stage of production. In principle, VAT applies to all provisions of goods and services. VAT is assessed and collected on the value of goods or services that have been provided every time there is a transaction (sale/purchase).

The seller charges VAT to the buyer, and the seller pays this VAT to the government. If, however, the purchaser is not an end user, but the goods or services purchased are costs to its business, the *tax it has paid for such purchases can be deducted from the tax it charges to its customers.*

In other words, each seller charges VAT on output (sales) and passes a buyer the amount of tax charged. Buyers, who are subject to VAT on their own sales (output), consider the tax on the purchases as input tax and can deduct the same from their own VAT liability. The difference between the output tax and input tax is paid to the Government. (Or refund is claimed in case of negativeliability)

Merits of VAT:

- ❖ **Elimination of Cascading Effect:** Since VAT paid on input can be set-off against VAT payable on sales and input VAT doesn't form part of the cost, therefore, VAT system prevents double taxation and avoids imposition of tax on tax.
- ❖ **Simple System:** It is a simple system of taxation. VAT simplifies tax calculations and filing of VAT returns.
- ❖ VAT requires maintenance of proper records for claiming credit of VAT paid on inputs and utilizing the same for payment of VAT on output.
- ❖ VAT promotes better accounting of business transactions, as maintenance of records and purchase invoices is a necessary pre-condition for availment of credit on purchases.



- ❖ VAT system promotes self- assessment by dealers. There are less procedural formalities like submissions etc.
- ❖ The buyers are aware of the amount of tax paid by them while purchasing the goods. The State Government also knows the exact amount of tax collected at each stage.
- ❖ VAT reduces the tax burden and helps reduce prices. Due to availability of credit of VAT paid on input against VAT payable on sales, cost of production is reduced and the retail sales price a great extent.

Demerits of VAT:

- ❖ In order to ensure genuine availment of credit, VAT system requires maintenance of detailed accounting records even by all dealers.
- ❖ The advantage of VAT system can be achieved only if there is single rate of VAT without any exemptions, concessions etc. The presence of different VAT rates, exemptions, concessions, composition schemes distorts the flow of audit trail introduced by VAT system.
- ❖ As compared to single point taxation at the time of last sale, VAT requires payment of tax at each stage of production or distribution.
- ❖ Due to increase in number of dealers under the VAT system, the cost of administration to the State gets higher.

Chartered Accountants Role:

The Chartered Accountants can play an important role in proper implementation of VAT by providing the following services:

- ❖ **Record Keeping:** VAT requires proper record keeping and account of purchases and sales, input credit on purchases and proper utilization of such credit against payment of tax on sales.
- ❖ **Tax Planning:** In order to minimize the incidence of tax, effective tax planning is required, which involves an analysis of the impact of various alternatives and selection of the best alternative.
- ❖ **Audit by department officers:** In case an audit is conducted by the VAT department of the State, the Chartered Accountant can represent his clients so as to satisfy the auditors by replying the queries and meeting out their audit objections, if any.
- ❖ **External Audit of VAT records:** In order to ensure compliance with the VAT laws, the laws of certain state provide for audit by external agencies in case the turnover of the assessee exceeds a specified limit.



Difference between Sales Tax and VAT:

Sales Tax	VAT
Sales tax is a single point tax, it is levied either at the time of first sale or at the time of last sales	VAT is a multi point tax, which is levied at the time of every sale.
Sales tax is levied on the full sale price	VAT is levied only on the value addition.
Sales tax system is complex with the multiplicity of taxes such as turnover tax, surcharge on sales tax etc.	VAT is simple and transparent. Multiple taxes has been abolished
The procedural compliances were complex.	There is lesser Department control due to self assessment by the dealers.
Under sales tax there is no provision for providing input tax credit.	Under VAT system, the dealer will be entitled to get credit on input tax paid.
A large no. of forms are required which leads to misuse of such forms	VAT dispenses with all such forms. Few forms were required as of now.

Difference between Zero rated or Nil rated goods Vs Exempted goods:

Nil or Zero rated goods	Exempted Goods
Nil rated or Zero rated goods are taxable goods but no tax is payable since the rate of tax is Zero.	Exempted goods are not taxable. Hence no VAT is to be payable on exempted goods.
In respect of Zero rated sales, the taxes paid earlier on purchases made for affecting that sale is refunded to the seller.	No such refund is allowed in respect of sale or exempted goods.
Export of goods outside India fall under Zero rate goods. Thus, no VAT is payable on export of goods. VAT paid on purchase of goods which are exported is refunded to the exporter within 3 months.	No such refund is given in respect of exempted sale.

Tax-free Goods: A Transfer goods mean the goods, for which the prescribed rate of tax is NIL in the Schedule to VAT law.



Taxable Goods: Goods other than tax free goods.

ICAI Role in VAT:

While various State Governments have issued detailed clarifications on practical issues arising while implementation of VAT, the role played by ICAI, as explained below:

- ❖ **Guidance Notes:** ICAI has issued Guidance Notes on Accounting for CENVAT as well as State level VAT, which addresses all accounting aspect thereof.
- ❖ **Comprehensive Study:** The Institute has also brought out 'a comprehensive study' containing general principles of VAT and State level VAT in India.



Input Tax Credit

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

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

If any Registered Dealer is purchasing goods within a particular State and has paid value added tax and subsequently the goods were sold either in the same State or to some other State, in that case such Registered Dealer shall be allowed to take credit for input tax, however, tax credit is allowed only to the Registered Dealers and further registered dealer should purchase goods only from registered dealer i.e. if the goods have been purchased from unregistered dealer, no VAT credit is allowed.

If raw material or other goods have been purchased and have been utilized in manufacturing, processing or packing of the product which is exempt from sales tax, no VAT credit shall be allowed for such sales tax.

Stock Transfer:

If any dealer has purchased goods within the state and the goods were stock transferred to some other state, in such cases VAT credit is allowed after retaining 2% of the input tax.

Tax credit in case of Export or supply to Special Economic Zone:

If the goods have been exported, in that case such export sales are exempt from excise duty or sales tax etc but even then as a special case tax credit is allowed and export goods are also called zero-rated goods. Similarly if the goods have been sold in Special Economic Zone, there will be same procedure as in case of export.

Special Economic Zone means a specific area which has been declared to be SEZ by the Government and the persons having their units in the SEZ shall be required to export the goods manufactured by them and there will not be any output tax.



Tax credit on capital goods:

If any person has purchased capital goods and such capital goods are to be used in the manufacturing of the goods which are taxable, in that case Tax credit should be allowed or not will depend in each case and there may be three situations

- (i) Tax credit is allowed in the same year i.e. **Consumption Variant**.
- (ii) Tax credit is allowed in installments depend upon the life of the capital asset i.e. **Income Variant**.
- (iii) Tax credit should not be allowed i.e. **Gross Product Variant**.

If the capital goods are being used for manufacturing of product which is exempt from sales tax, no VAT credit shall be allowed. If capital goods are to be used for manufacturing of taxable goods as well as exempt goods, in that case only proportionate VAT credit is allowed.

Scope of input tax credit:

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

1. For sale/resale within the State;
2. For sale to other parts of India in the course of inter-state trade or commerce;
3. To be used as containers or packing materials or raw materials or consumable stores, required for the purpose of manufacture of taxable goods or in the packing of such manufactured goods intended for sale;
4. For being used in the execution of a works contract (rendering of services along with supply of goods e.g. construction contract);
5. To be used as capital goods required for the purpose of manufacture or resale of taxable goods;
6. To be used as raw materials or capital goods or consumable stores and packing materials/containers for manufacturing/packing goods to be sold in the course of export out of the territory of India.



Purchases not eligible for input tax credit:

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

1. Purchases from unregistered dealers;
2. Purchases from registered dealer who opt for composition scheme;
3. Purchase of goods as may be notified by the State Government;
4. Purchase of goods, which are being utilized in the manufacture of, exempted goods;
5. Goods in stock, which have suffered tax under an earlier Act but under VAT Act they are covered under exempted items;
6. Goods imported from outside the territory of India;
7. Goods imported from other States.

Carrying over of tax credit:

Input tax credit is first to be utilized for payment of VAT. The excess credit can be then adjusted against the central sales tax (CST) for the said period. After the adjustment of VAT and CST, excess credit, if any, will be carried over to the end of the next year.



VAT Liability

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

Methods for computation of VAT liability:

Three most commonly used methods for computation of value added to the goods for levied of VAT or mentioned below:

Addition method i.e. value added = Factor payments + Profit;

- ❖ In this method, the value added is arrived at by aggregating all factor payments and profits. The factor payments mean payments made to all the factors of production viz. rent/depreciation of building, hire charges/ depreciation of machinery, interest on capital, wages and salaries etc.
- ❖ In case where exemptions have been provided at certain intermediate stage of sale, this method levies tax on the value addition inclusive of value of those exempted goods. Thus, this method creates difficulty in accommodating the exemptions provided to intermediate dealers/goods.
- ❖ Since this method doesn't facilitate matching of sales invoices with purchases invoices, it becomes difficult to detect evasion of tax.

Invoice method or tax credit method or voucher method i.e. VAT payable = VAT on sales – VAT on inputs

- ❖ Under this method, VAT is imposed at each stage of sales on the total sale value or sale price. The amount of VAT is charged separately in the invoice and the total amount of VAT due on sales is recovered from the buyer.
- ❖ The amount of VAT paid at earlier stage is allowed as credit/set-off/deduction from the amount of VAT payable on sales. In other words, VAT payable = VAT due on sales – VAT paid on inputs. Thus, at each stage, seller pays VAT only on the amount of value addition made at that stage.



Subtraction Method:

Under this method, the tax is charged only on the value added at each stage of the sale of goods. Value added means the difference between sale and purchases.

This method is generally followed when tax is not charged separately in the invoice i.e the sales invoice shows sale price inclusive of tax.

VAT liability = $\frac{\text{Rate of VAT}}{100} + \text{Rate of VAT} * \text{Taxable turnover}$.

Different Kinds of subtraction method:

❖ Direct Subtraction method:

Value added = Aggregate value of Sales exclusive of tax – Aggregate value purchases exclusive of tax.

❖ Intermediate Subtraction method:

Value added = Sales – Tax inclusive value of purchase.

❖ Indirect Subtraction method:

Value added = Tax inclusive value of sales – Tax inclusive value of purchases.



Composition Scheme

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

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

Merits:

- ❖ Saves a lot time, labour and expenditure in keeping records;
- ❖ Simplifies calculation of tax liability;
- ❖ Reduces the amount of tax payable;
- ❖ A single return may cover longer period.

Demerits:

- ❖ No input tax credit;
- ❖ Dealer can not issue VAT-able invoices;
- ❖ While VAT payable can be collected from the buyer, the dealer cannot collect the composite tax payable by him from the buyer.

Eligibility for the Composition Scheme:

Every registered dealer who is liable to pay tax under the respective State VAT Acts and whose turnover does not exceed ₹ 50 lakhs is generally entitled to avail this scheme.

However, the following are **not eligible** for the composition scheme:

- (i) A manufacturer or a dealer who sells goods in the course of inter-state trade or commerce; or
- (ii) A dealer who sells goods in the course of import into or export out of the territory of India.
- (iii) A dealer transferring goods outside the State otherwise than by way of sale or for execution of works contract.



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

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

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



VAT PROCEDURES

Registration

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

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

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

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

All sales or purchases of goods made within the State except the exempted goods would be subjected to VAT.

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

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



Cancellation of registration: The registration can be cancelled on:

- (i) Discontinuance of business; or
- (ii) Disposal of business; or
- (iii) Transfer of business to a new location; or
- (iv) Annual turnover of a manufacturer or a trader dealing in designated goods or services falling below the specified amount.

Tax Payer's Identification Number (TIN)

TIN (Tax Payer's Identification Number) is a code to identify a tax payer. It is the registration number of the dealer. The taxpayer's identification number will consist of 11 digit numerals throughout the country. TIN will facilitate computer applications, such as detecting stop filers and delinquent accounts. TIN will help to cross-check information on tax payer compliance, for example, the selective cross-checking of sales and purchases among VAT taxpayers.

Tax Invoice: Every registered VAT dealer must issue to the purchaser, a serially numbered cash memo or bill or invoice showing the correct details as required by law.

This is an important document for input tax credit. The tax invoice must be signed and dated by the dealer or his regular employee. The dealer must keep a counter foil of duplicate of such tax invoice duly signed and dated.

Tax Invoice should contain following particulars:

- ❖ The word 'Tax Invoice' must appear in bold letter at the top or prominent place.
- ❖ Name, address and TIN of the selling dealer.
- ❖ Name and address of the purchasing dealer.
- ❖ Serial number and date.
- ❖ Description, quantity and price of the goods sold.
- ❖ The amount of tax charged is to be charged separately.
- ❖ Signed by the selling dealer or a person authorized by him.

Records to be maintained: Every dealer liable to pay tax under VAT law should maintain the following records:

- ❖ Value and quantity of Purchases;
- ❖ Value and quantity of goods manufactured;
- ❖ Value and quantity of sales;
- ❖ Value and quantity of goods disposed of otherwise than by way of sale;
- ❖ Value and quantity of inventory or stock;
- ❖ Record of exempted sale;



- ❖ Copies of all invoices, credit and debit notes, issued in serial number;
- ❖ Details of the amount of tax charged on each sale or purchase;
- ❖ All the purchase invoices, credit and debit note received;
- ❖ VAT account and total of the output tax and input tax in each period and net of total tax payable or excess carried forward, as the case may be at the end of the each month.

All these records should be preserved for the period specified in the respective state laws.

Return and payment of tax and Assessment procedure:

Every registered dealer has to furnish the return duly signed by him. Every registered dealer shall file correct, complete returns.

Any return shall be treated to be complete only if the following particulars are given correctly in the return:

- Turnover of sales and purchases;
- Claim of set-off;
- Amount of set-off and carried forward;
- Calculation of tax.

Self Assessment:

VAT system heavily depends on self assessment by the dealers. Under the self assessment scheme filling of correct return is very crucial as the payment of tax depends on the returns filed and in many cases they are not going to be assessed by the department.

VAT liability will be self assessed by the dealers themselves or voluntary return will be submitted after setting off the tax credits. There is no longer a compulsory assessment at the end of the each year as was applicable under the old system.

VAT audit and Role of Chartered Accountant in VAT audit:

Most of the State VAT laws in India provide for audit of accounts of registered dealer, if his turnover exceeds an amount specified in the law itself. Such audit is carried on by a Chartered Accountant and report thereof is to be submitted in prescribed form within the prescribed time.

VAT audit ensure effective implementation of the VAT law.

VAT audit is necessary for the following reasons:

- ❖ It is necessary to bridge the gap between the requirements of VAT law and level of education and awareness of the trader about the VAT system.



- ❖ Due to resource crunch in the tax administration, they cannot ensure that the requirements of VAT law are being complied with and there is no loss of revenue.
- ❖ Control the tax evasion.

Role of auditor:

VAT audit provides a knowledge resource in form of qualified professionals to the Department, to ensure that the VAT laws are being complied with.

VAT audit involves minute verification, by an independent auditor, of the books of accounts, records and other documents maintained by dealers. By verification of books of accounts and analysis and interpretation of provisions of VAT law, the auditor can report any under assessment requiring payment by dealer or over assessment requiring refund claim by him.

VAT audit is a tool to control tax evasion. VAT ensures an effective check over tax evasion measures like production of fake invoices, etc thereby ensuring that the Government gets the due share of its revenue.

Tax Rates Under VAT

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

