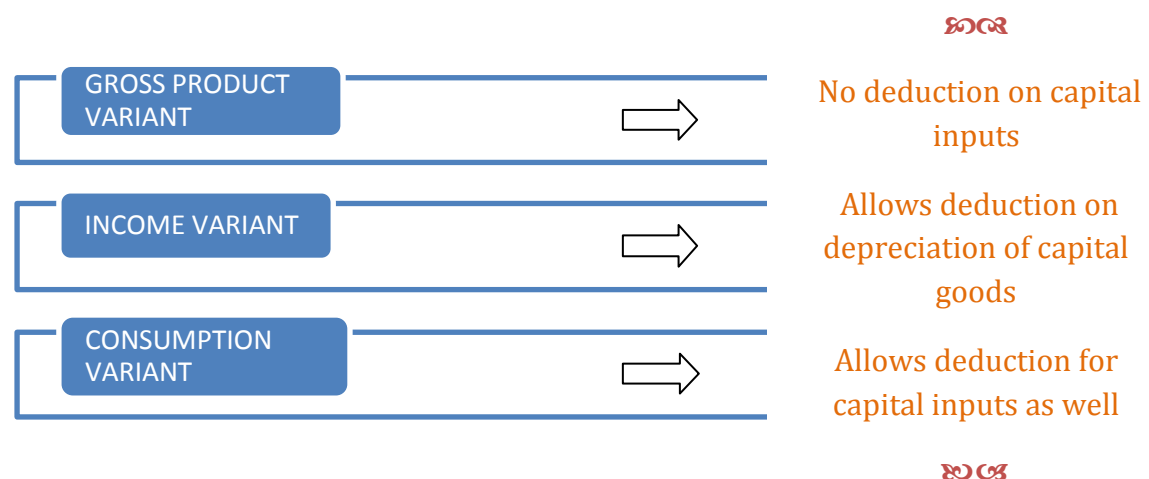


VAT – POINTS TO REMEMBER (Concepts and General Principles)

1. Tax will be levied and collected at each stage of manufacture but only on the value added by the manufacturer, represented by the purchase value and the value of work performed on such commodities.
2. Excise duty is levied on the manufacture of goods.
3. In 1986, VAT was introduced in India under a different name of Modified Value Added Tax (MODVAT).
4. Scope of MODVAT has been increased over the years and has since been renamed as Central Value Added Tax (CENVAT) which includes services also.
5. VAT is revenue productive.
6. VAT is a multi-stage tax levied as a proportion of the value added (i.e. sales-purchase).
7. Ad-valorem: Latin for 'according to value'; in proportion to the estimated value of the goods or transaction concerned.
8. Interest is assumed to be a manufacturing expense.
9. Set off of VAT paid on imported goods (from other states or outside the country) is not allowed, in other words, input tax credit is not allowed on interstate purchases.
10. There are three variants of VAT:



11. a. **GROSS PRODUCT VARIANT:**

This variant allows deductions on all purchases of raw materials and components but no deduction is allowed for taxes on capital inputs. (capital goods carry a heavier tax burden as they are taxed twice)

b. **INCOME VARIANT:**

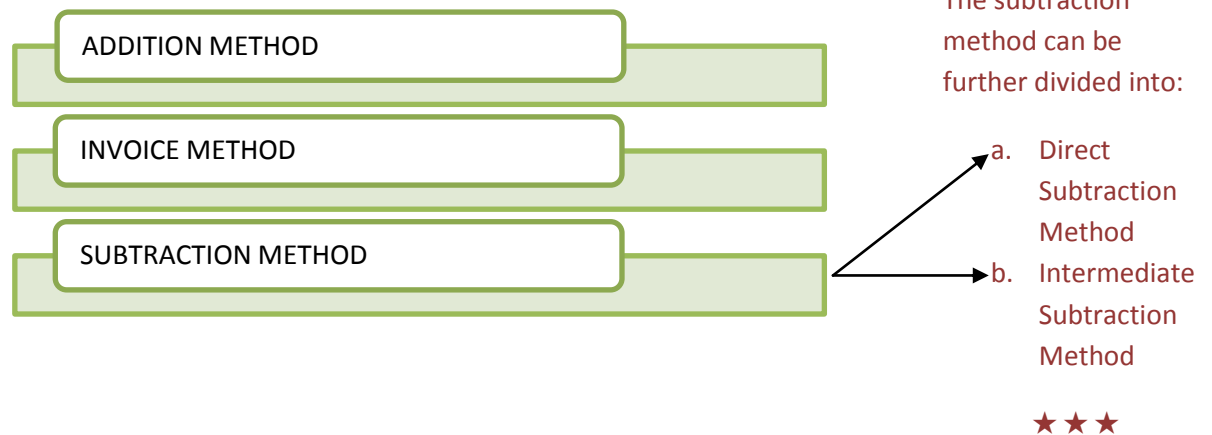
This variant allows for deductions on purchases of raw material and components as well as depreciation on capital goods. However, practically there are many difficulties associated with specification of any method of calculating depreciation.

c. **CONSUMPTION VARIANT:**

This variant allows for deductions on all business purchases including capital assets. It does not distinguish between capital and current expenditure. This variant is neutral between the methods of production (capital intensive or labour intensive); it is also neutral between the decision to save or consume.

12. The consumption variant is the most widely used.
13. The preference of consumption variant is because of the following reasons :
 - a. It does not effect decision regarding investment.
 - b. This system is tax neutral in respect of techniques (methods) of production.
 - c. It simplifies tax administration by obviating the need of distinguishing between intermediate & capital goods and consumption goods.
 - d. Most VAT countries include services, and since the business gets the set off of tax on services, it does not cause any cascading effect.

14. Methods of computation of VAT:



15. a. **ADDITION METHOD:**

This method aggregates all the factor payments including profits to arrive at the total value addition on which the tax rate is applied.

Drawback → It does not facilitate matching of invoices for detection of evasion.

Mainly used with income variant of VAT.

b. **INVOICE METHOD:**

Under this method, tax is imposed at each stage of sales on the entire sales value and the Tax paid at an earlier stage is allowed as set off.

At each stage, Tax is to be charged separately in the invoice.

This is the most common and popular method for computing tax under the VAT system.

Tax credit cannot be claimed until and unless the purchase invoice is produced.

Possibility of Tax evasion is reduced to a minimum.

It is also called the 'Tax Credit Method' or 'Voucher Method'.

c. SUBTRACTION METHOD:

Under this method, tax is imposed only on the value added at each stage. ↔

Value added = Value of Sales – Value of Purchases.

Incidence of tax on the final sale price to the consumer will remain the same as in the earlier stage. However if the rate of tax is not common, then the final tax by the two methods may differ. This method is not considered as a good method.

This method is normally applied where tax is not charged separately.

**Commensurate:*
Corresponding in size or degree; in proportion.

16. MERITS AND DEMERITS OF VAT:

17. The central and state governments derive their powers from 3 lists
- *Union List*
 - *State List*
 - *Concurrent List*
18. Income Tax, Excise Duty and Customs Duty constitute the major sources of tax revenue to the central government.
19. The state government depends on sales tax (VAT) as their major source of tax revenue.
20. CENVAT means tax on value addition on the goods manufactured according to the Central Excise and Customs Act definition. Value addition means the additional services/activities, etc which helps in conversion of input to output.
21. Prevailing structure of duties payable by the manufacturer on removal of goods from the factory at prescribed rates:

- **CENVAT**
- **Special Excise Duty (SED)**
- **Additional Excise Duty on goods of special importance AED, (GSI)**
- **Additional Duty of Excise on textiles and textile articles AED, (T&TA)**
- **Cesses on specified commodities**

22. At present CENVAT is governed by CENVAT CREDIT RULES, 2004.
23. The committee of state finance ministers recommended several measures to rationalize the existing sales tax like simplification of the rates structure, minimization of the exemptions, and enhancement of transparency; the ultimate aim was to introduce VAT at the state level.
24. WHITE PAPER: The Empowered committee of state finance ministers brought out the White Paper on 17-01-2005, which provided the base for preparation of various state VAT legislations.
25. Broadly, The White Paper consists of the following:
- Justification of VAT and background.
 - Design of state-level VAT.
 - Steps taken by the states.

As VAT is a state subject, the states will have the freedom for appropriate variations consistent with the basic design as agreed upon at the empowered committee.

26. State level VAT was finally introduced 01-04-2005 by majority of the states.
27. With the introduction of VAT it is proposed to phase out central sales tax (CST).
28. Under the VAT system, a major thrust is to be laid on 'self-assessment'.
29. There is a strong need to see that tax payers discharge their tax liability properly while filing the returns.

Since, the states will stand to lose large amount of revenue on phasing out CST, a mechanism is being thought of for compensating the states for such loss.

30. This can be only ensured when the particulars furnished by the tax payers are verified by an independent auditor in minute details by:
 - Going through the books of accounts
 - Analysing the state-level VAT
 - Interpreting the provisions of the state-level VAT laws
 - Reporting the under-assessment, if any, made by the dealer
 - Reporting the over-assessment or excess payment of tax, warranting refund to the tax payer
31. It is essential that the audit of the proposed VAT system is attempted on a regular basis. The criteria for audit can be the amount of turnover or the class of dealer dealing in specified commodities.
32. Since VAT is a new concept, some states want to keep the procedural formalities to a minimum; Hence, at the initial stage their law makers refrain from keeping any audit provisions in their acts and rules.
33. Role of ICAI in VAT:
 - ICAI has rendered pioneering service in evolving the necessary guidelines for accounting of CENVAT as well as state-level VAT.
 - These guidelines address all the accounting issues in regard to CENVAT and state-level VAT.
 - The institute has brought out a comprehensive study for an elaborated discussion of the various general principles of CENVAT and state-level VAT.

34. Role of CA in VAT:

RECORD KEEPING

- Systematic records of input credit and its utilisation is necessary for the success of VAT. CA's are well equipped to perform such tasks.

TAX PLANNING

- A CA is competent to analyze the impact of various alternatives and choose the most optimum method of purchases and sales in order to minimize the tax impact.

NEGOTIATIONS WITH SUPPLIERS TO REDUCE PRICE

- A CA will ensure that the benefit of cost reduction is passed on by the suppliers to his company. However, if the buyers of his company make a similar demand, he must be ready with full data to resist their claims.

HANDLING THE AUDIT BY DEPARTMENTAL OFFICERS

- A certain percentage of dealers will be taken up for audit every year on a scientific basis. CA can ensure proper record keeping in order to satisfy the officers of audit department. Expertise of CA will help him to effectively reply to the audit queries

EXTERNAL AUDIT OF VAT records

- Under the VAT system, only a few returns will be scrutinized and there will be no regular assessment of all VAT returns; Thus a CA can play a vital role in ensuring tax compliance by audit of VAT accounts.

GOODS AND SERVICE TAX: GST IS AN INDIRECT TAX AIMED AT ATTAINING A COMPREHENSIVE AND HARMONIZED TAX STRUCTURE. IT WILL REPLACE ALL THE INDIRECT TAXES LEVIED ON GOODS AND SERVICES BY THE INDIAN CENTRAL AND STATE GOVERNMENTS. GST WILL BE IMPLEMENTED CONCURRENTLY BY THE CENTRAL AND THE STATE GOVERNMENTS AS THE CENTRAL GST AND THE STATE GST RESPECTIVELY. EXPORTS WILL BE ZERO RATED AND IMPORTS WILL BE LEVIED THE SAME TAXES AS DOMESTIC GOODS AND SERVICES ADHERING TO THE DESTINATION PRINCIPLE.

GST IS AIMED AT:

- ACCOMPLISHING A COMMON DOMESTIC MARKET
- REMOVING MULTIPLICITY OF TAXES
- ELIMINATING THE CASCADING EFFECT OF TAX ON TAX
- MAKING THE PRICE OF INDIAN PRODUCTS COMPETITIVE
- BENEFITING THE END CONSUMERS

