

VAT – POINTS TO REMEMBER (INPUT TAX CREDIT AND COMPOSITION SCHEME FOR SMALL DEALERS)

PART - 1

- I. **Input Tax** is the tax paid or payable by a dealer on local purchases of business inputs which include raw material, capital goods as well as other inputs which are used directly or indirectly in his business.
- II. **Output Tax** is the tax collected by the dealer on his sales that are subject to tax.
- III. **Input Tax Credit** in relation to any period means setting off of the input tax against the output tax, i.e., deduction of the tax paid on local purchases for the production of non-exempted goods from the gross tax liability on the sales of the goods.
- IV. Input Tax Credit shall be allowed to every **registered dealer for purchases made within the state** from a dealer holding a valid certificate of registration under the Act.
- V. Input Tax Credit will be given to both manufacturers and traders for purchase of inputs/supplies meant for both **sales within the state as well as to other states** irrespective of when these will be utilized/sold.
- VI. In case of **Stock Transfer** of goods **out of the state**, input tax paid in excess of 2% will be allowed as tax credit.
- VII. In some states, partial input tax credit is available in respect of inputs used for the manufacture of exempted goods.
- VIII. **Tax credit on capital goods may be adjusted over a maximum of 36 monthly equal instalments.** 
- IX. In Maharastra, full input tax credit on capital goods is given in the month of purchase only. However, if the capital asset is sold within a period of 36 months, proportionate input credit will be withdrawn.
- X. There is a negative list of capital goods (capital goods not eligible for input tax credit).
- XI. **Liability of Central Sales Tax (CST) can be set-off against excess of VAT credit.**
- XII. A Purchase is eligible for tax credit only if it utilised towards production of taxable goods.
- XIII. Where the purchased inputs are utilised partially for manufacture of exempted goods and partially for taxable goods, **input tax credit shall be allowed proportionate to the extent the inputs are utilised for taxable goods.**

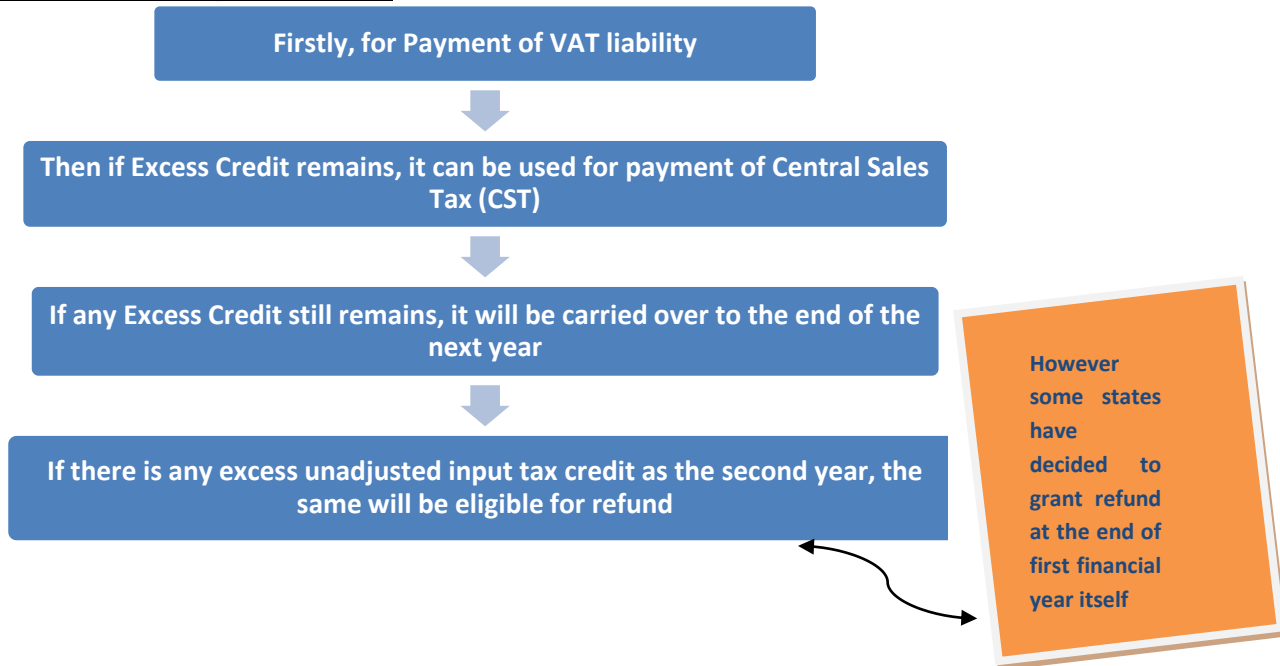
The states have the option to reduce the number of instalments

XIV. **Eligible Purchases For Availing Input Tax Credit:**

- Purchases from a **registered dealer**.
- For sale/resale within the state.
- For sale to other parts of India in the course of inter-state trade or commerce.
- For being used in the **execution of a works contract**.
- To be used as **capital input** required for the **manufacture of taxable goods**.
- For **making zero-rated sales** (within the territory of India).
- To be used as –
 - A. Raw Materials
 - B. Containers Or Packing Materials
 - C. Consumable Stores
 - D. Capital Goods
 - i. Required for the **manufacture of taxable goods** intended for **sale in the state or in the course of inter state-trade** or commerce.
 - ii. For **manufacturing goods to be sold in the course of export** outside the territory of India.

XV. **Purchases Not Eligible For Input Tax Credit:**

- Purchases from **unregistered dealers**.
- Purchases from registered **dealer** who has **opted for composition scheme**.
- Purchase of goods where the **purchase invoice is not available**.
- Purchase of goods where the **invoice does not show the amount of tax charged separately**.
- Purchase of inputs for the **manufacture of exempted goods**.
- Goods in stock which suffered tax under an earlier act but under VAT they are exempted goods.
- Purchase of goods for **personal use**.
- **Inter-state purchases**
- **High seas purchases** (goods imported from outside the territory of India).
- Purchase of **goods notified by the government as ineligible** for tax credit.

XVI. Utilisation of input tax credit:XVII. Refund to Exporters:

The White Paper provides for the grant of refund of the input tax paid for the exported goods within a period of **3 months** from the end of the period in which the transaction took place.

XVIII. Units located in **Special Economic Zone (SEZ)** and **Export Oriented Units (EOU)** are either **granted exemption from payment of input tax** or refund of the input tax paid within 3 months.

State Government may reduce the time period of 3 months

XIX. Normally under VAT system, a dealer should get full input tax credit on purchases of capital goods more particularly when the basic principle is to avoid cascading effect.

While fixing the sale price of the business products the dealer has to include some portion towards the cost of acquisition of the capital asset in the sale price of the product. If input tax credit is not allowed in full, then certainly, to the extent of disallowance the purpose of VAT gets defeated.

XX. When tax paid on purchases is included in cost, the said tax **is indirectly reflected in the sale price of the product** and hence there is also an **element of tax on tax**, i.e., cascading effect of tax.

XXI. Policy In White Paper:

- In relation to capital goods, set-off will be available to both manufacturers and traders. Under the traditional sales tax system, partial credit was allowed on capital goods to the manufacturers but no credit was allowed to the traders.
- The White Paper, taking into account the very basis of VAT, laid down the policy to **grant set-off to both manufacturers and traders**.
- According to White Paper, the **state governments can provide to give set-off on a staggering basis, at the most in 36 instalments** (subject to the policy of individual states).

XXII. Restrictions On Credit Relating To Capital Goods:

As per the White Paper, there will be a negative list of capital goods which will be based on certain pre-agreed principles by the Empowered Committee. Those goods will not be eligible for input tax credit.

XXIII. The dealers will have to bifurcate their capital input purchases into goods eligible for set-off and goods ineligible for set-off.

- The dealer will be required to follow the procedural requirements in respect of eligible goods.
- He has to then comply with further provisions of allowability; if it is subject to certain instalments, the dealer will be required to claim set-off accordingly in his returns.
- If the set-off is subject to prior permission the same should be obtained.

XXIV. If the vendor fails to make payment of tax to the government, the purchaser's claim of set-off will be denied inspite of the fact that he has paid the tax to his vendor.

PART-2**I. Provisions regarding the composition scheme laid down in White Paper:**

- Small dealers who are otherwise liable to pay VAT, with the **gross turnover not exceeding Rs.50 lakhs**, shall have the option for a composition scheme with payment of tax at a small percentage of the turnover.
- The dealers who opt for the composition scheme shall not be eligible for input tax credit.

II. The White Paper specifies that registration for VAT will not be compulsory for dealers below a **threshold turnover of Rs.5lakhs. There is a provision for a simpler composite scheme for those dealers.**

However, the empowered committee of state finance ministers allowed the states to increase the threshold limit for the small dealers to Rs.10 lakhs provided that the concerned state would bear the revenue loss on account of increase in the limit beyond Rs.5 lakhs.

- III. The empowered committee has permitted the states to reduce the rate of composition tax to as low as 0.25%**
- IV. The **composition tax can now be levied on the taxable turnover** instead of the gross annual turnover.**

V. Features Of Composition Scheme:

- The advantage of this scheme is that **it saves a lot of time, labour and efforts in keeping and maintaining records**. Also, it simplifies the tax calculation for the dealer.
- Such schemes generally have the following features:
 - **A very small amount of tax will be payable**
 - **There will be a simple return form to cover long return period**

- VI. The major **disadvantage** of this scheme is that the **dealer will not be eligible for input tax credit and will not be able to issue tax invoices in order to pass on the tax credit**. Therefore, dealers who desire of input tax credit on their purchases **may not prefer to buy from composite dealers**.

VII. Eligibility for composition scheme:

Every registered dealer who is liable to pay tax under the respective State Vat Acts and whose turnover does not exceed Rs.50 lakh in the financial year is generally entitled to avail this scheme.

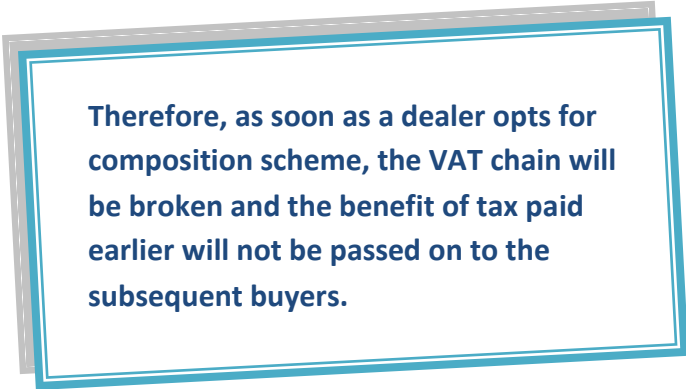
VIII. Non-Eligibility for the composition scheme:

1. A manufacturer or dealer who sells goods in the course of inter-state trade or commerce.
2. A dealer who sells goods in the course of import into or export out of the territory of India
3. A dealer transferring goods outside the state otherwise than by way of sale or for execution of works contract.

- IX. A dealer can exercise his option to opt for the composition scheme in writing for a year or part of the year in which he gets himself registered to the commissioner.
- X. If a dealer opts for this scheme, he does not need to maintain any statutory records as prescribed under the Act. He needs to maintain only the records of purchase, sale and inventory.
- XI. The dealer should not have any stock of goods that were brought from outside the state on the day he exercises his option to pay tax by the way of composition and shall not use goods brought from outside the state after that date.

XII. VAT chain under Composition Scheme:

- **Loss to the seller:** The dealer who opts for this scheme will not be able to pass on the benefit of input tax credit, which will add to the cost of the goods.
- **Loss to the purchaser:** The purchaser shall not get any input tax credit for the purchases made by him from a dealer operating under this scheme.



Therefore, as soon as a dealer opts for composition scheme, the VAT chain will be broken and the benefit of tax paid earlier will not be passed on to the subsequent buyers.

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.

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.

The White Paper provides for the grant of refund of the input tax paid for the exported goods within a period of **3 months** from the end of the period in which the transaction took place.

Policy In White Paper:

- The White Paper, taking into account the very basis of VAT, laid down the policy to grant set-off to both manufacturers and traders.
- According to White Paper, the state governments can provide to give set-off on a staggering basis, **at the most in 36 instalments** (subject to the policy of individual states).

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EMPOWERED COMMITTEE OF STATE FINANCE MINISTERS

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.

The committee recommended several preparatory steps to be taken for preparation of a full-fledged State level VAT. For implementing those steps, an Empowered Committee Of State Finance Ministers was set up.

The Empowered committee of state finance ministers held regular meetings and brought out the White Paper on 17-01-2005, which provided the base for preparation of various state VAT legislations.

The empowered committee of state finance ministers subsequently allowed the states to increase the threshold limit from Rs.5 lakhs to Rs.10 lakhs provided that the concerned state would bear the revenue loss on account of increase in limit beyond Rs.5 lakhs.