OLD RULE VS NEW RULE

OLD RULE	GVT	NEW RULE	GVT

The background and justification of VAT

1. In the old sales tax structure, there were problems of **double taxation** of commodities and **multiplicity** of taxes, resulting in a **cascading** tax burden. This results an unfair **double taxation** with cascading effects.
2. The VAT **not only provides full set-off** for input tax as well as tax on previous purchases, but it also abolishes the burden of several other taxes, such as turnover tax, surcharge on sales tax, additional surcharge, special additional tax, etc.
3. As commonly levied, the value added tax constitutes a method of **taxing final consumer** spending in the economy **by installments or in stages**.
4. The method consists of levying a tax on value added to **a** product at **each stage of its production and distribution**.
5. For this purpose **'value added'** is taken as the **difference** between the **sales and purchases** of intermediate products or goods for resale of **a** business.
6. **VAT is a multi-stage tax** that it is levied on the value added at each stage

7. This ensures **that each input** that goes into a final product is **taxed** once and **only once**, and not cumulatively as under a turnover tax and thus avoids causing cascading associated with turnover taxes.

VAT liability

1. VAT is based on the **value addition** to the goods, and
2. The related VAT liability of the dealer is calculated by **deducting input tax credit from tax collected on sales** during the payment period.
3. 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.

Computation of VAT liability

WN1: OUTPUT VAT

Output tax is tax charged or chargeable by a registered dealer for the **SALE** of goods in course of business.

WN2: INPUT VAT

Input tax is the tax paid or payable in the course of business on **PURCHASE** of goods from a registered dealer of the State.

Taxpayer's Identification Number

1. The Taxpayer's identification number will consist of 11 digit numerals throughout the country.
2. First two characters will represent the State Code as used by the Union Ministry of Home Affairs, Government of India (census code).
3. The set-up of the next nine characters may, however, be different in different States. This will include 2 check digits.

SET OFF

Credit is available in respect of purchases given below—	**No credit** is available in respect of purchases given below—
1. for sale/resale within State; **2.** for sale to other parts of India in course of inter-State trade or commerce; **3.** for being used in execution of a works contract; **4.** to be used as capital goods required for the purpose of manufacture and resale of taxable goods; **5.** for making zero rated sale; **6.** to be used as containers or packing material, raw material, consumable stores, manufacture of taxable goods or in the packing of such manufactured goods (intended for sale in the State or in the course of inter-State trade or commerce).	**1.** Goods purchased from **unregistered** dealers. **2.** Goods purchased from **other States**/countries. **3.** Purchase of goods used as **fuel** in power generation. **4.** Purchase of goods to be dispatched as **branch** transfers outside States. **5.** Purchase of goods in cases where the dealer **does not have invoices** showing amounts of tax charged separately by the selling dealer. **6.** Purchase of goods used in manufacture of **exempted goods.** **7.** Purchases from a dealer who has opted for **composition scheme** (these schemes may be specified in the law regulating VAT in a particular set). **8.** Purchase of **non-creditable goods** (these goods may be defined in the law regulating VAT in a particular set). **9.** Purchase of **capital goods** (in some cases credit is available in installments). **10.** Purchase of goods used in manufacture of goods to be dispatched outside any State as branch transfer/consignments

REGISTRATION UNDER VAT

Voluntaryregistration	1. **<u>OLD DEALER :</u>** all dealers under the old system of local sales tax have been automatically registered under the VAT Act 2. **<u>NEW DEALER :</u>** A. Registration of dealers with gross annual turnover above a specified amount (say, Rs. 5 lakh) is compulsory. B. Generally, there is a provision for voluntary registration. C. A new dealer is generally allowed 30 days time from the date of liability to get registered.
Compulsory registration	1. If an assessee (who is otherwise required to get registration) fails to obtain registration under the VAT Act, 2. He/it may be registered compulsorily by the Commissioner. 3. Failure to get registered shall result in attracting default penalty (penalties) and forfeiture of eligibility to set off all input tax credit related to the compulsory registration.
Optional registration -	A dealer (who is otherwise not eligible for registration) may also obtain registration if the Commissioner is satisfied that the business of applicant requires registration.

NOTE **Cancellation of registration -The registration can be cancelled in the following cases—**

1. discontinuance of business;

2. disposal of business;
3. transfer of business to a new location or
4. annual turnover of a manufacturer or a trader dealing in designated or services falling below the specified amount

Stock Transfer

Inter-State stock transfer does not involve sale. Such a transaction is generally not subject to sales tax. The same position is adopted by the different States under the VAT regime. Generally, the tax paid on—

1. inputs used in manufacture of finished goods which are stock transferred; or
2. purchase of goods which are stock transferred,

is available as input tax credit after a retention of 2 per cent of such tax by the concerned State Government

INVOICE

Invoice is a document listing goods sold with price, tax charged and other details as may be prescribed and issued by a dealer authorized under the Act.

The whole structure of the VAT with input tax credit is founded on the documentation of a tax invoice, a cash memo or a bill. The **White Paper mainly provides for the following provisions, which are mandatory, and failure to comply with these attracts penalty:**

(i) Every registered dealer whose turnover of **sales exceeds the specified amount** shall issue to the purchaser a **serially numbered tax invoice**, cash memo or bill with the prescribed particulars.

(ii) The tax invoice shall be **dated and signed** by the dealer or his regular employee, showing the required particulars.

(iii) The dealer shall keep a **counterfoil or duplicate** of such tax invoice duly signed and dated.

Composition Scheme

ELIGIBILTY-	1. Small dealers with annual gross turnover **not exceeding a specified amount** (say, Rs. 50 lakh) 2. who are **otherwise liable to pay VAT**, shall 3. however have **the option** for a composition scheme with payment of tax at a small percentage of gross turnover. 4. This option can **be exercised in writing** for the entire year (or for a part of the year in which he gets himself registered). 5. This option should be intimated to the **Commissioner**. He is not required to maintain any statutory records as prescribed. 6. Only the records for purchase and sale inventory should be maintained
Features of Composition Scheme	1. The advantage of this scheme is that it **saves** a lot **of labour** and effort in keeping records. 2. **Simplifies** calculation of tax liability of a dealer. 3. very **small tax** is payable 4. there will be a **simple return** form to cover longer return period.
Dis – advantage	1. The major disadvantage of this scheme is that the dealer is **not** eligible to avail **input tax credit.** 2. Moreover, he/**it cannot issue tax invoices** in order to pass on tax credit to the purchasers.
NOT eligible for the Composition	The following persons are not eligible for Composition Scheme— **a.** a manufacturer or a dealer who sells goods in course **of inter-State** trade or commerce.

Scheme	**b.** a dealer who sells the goods in course **of import into or export out** of territory of India. **c.** a dealer transferring goods **outside the State** otherwise than by way of sale or for execution of works contract.

NON CREDITABLE GOODS

In general, all the goods, including declared goods will be covered under VAT and will get the benefit of input tax credit. However, there are a few goods which are outside VAT. Generally, exempted category includes

1. liquor,
2. lottery tickets,
3. petrol, diesel, aviation turbine fuel and
4. other motor spirit since their prices are not fully market determined.

These will continue to be taxed under the Sales Tax Act or any other State Act or even by making special provisions in the VAT Act itself, and with uniform floor rates.

VAT CREDIT ON CAPITAL GOODS

1. In India consumption variant is adopted .
2. i.e setoff will be available on capital goods
3. However setoff will be available on capital goods in **maximum 36 monthly** installments
4. Number of installments can be reduced by state government depending upon state act/rules

VARIANTS OF VAT

There are three variants of VAT viz, gross product variant, income variant and consumption variant.

1. **Gross Product Variant:** Under this variant, deduction is allowed for tax paid on all inputs excluding capital inputs.
2. **Income Variant:**Under this variant, tax paid on non-capital inputs and depreciation on capital inputs is allowed.
3. **Consumption variant:** Under this variant, deduction is allowed for tax paid on all business inputs including capital inputs.

NOTES;

1. 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.
2. There is neither any differentiation between capital and revenue expenditures nor the life of assets or depreciation allowances for different assets is specified.
3. 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.
4. 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.

CARRYING OVER TAX CREDIT

1. If input tax credit for a particular tax period exceed the output VAT payable then such excess tax credit can be carry forwarded to the next tax period
2. If any excess credit remains at the end of financial year then such excess credit is generally eligible for refund

METHODS OF COMPUTATION OF VAT

Addition Method	1. This method is based on the identification of value-added, which can be estimated by summation of all the elements of value-added *(ie.,*wages, profits, rent and interest). 2. This method is known as addition method or income approach. 3. This is in line with the income method of calculating national income. 4. The chief drawback of this method is that it does not require matching of invoices in order to check tax evasion.
Subtraction Method	1. The subtraction method estimates value-added by means of difference between outputs and inputs. 2. This is also known as product approach and has further variants in the way subtraction is attempted from among (a) direct subtraction method, (b) intermediate subtraction method, and (c)indirect subtraction method. 3. Direct subtraction method is equivalent to a business transfer tax whereby tax is levied on the difference between the aggregate tax-exclusive value of sales and aggregate tax-exclusive value of purchases. 4. Intermediate subtraction method is based on deduction of the aggregate tax-inclusive value of purchases from the aggregate tax-inclusive value of sales and taxing the difference between them
Tax-Credit Method	1. Under the tax credit method, the tax on inputs is deducted from the tax on the sales to arrive at the VAT payable by the dealer. 2. The indirect subtraction method entails deduction of tax on inputs from tax on sales for each tax period, 3. This method is also known as tax credit method or invoice method. In practice, most countries use this method and employ net-consumption VAT. **VAT payable =** Total tax charged on the outputs or sales *Minus* Total tax paid to the suppliers on inputs or purchases

Advantages And Adopt/On OF Tax Credit Method –

Tax Credit or Invoice Method has been adopted universally because of the inherent advantages in the credit method of calculating tax liability. The other methods namely addition method and subtraction method are not workable in the case of a manufacturer when the rate of tax is different in respect of inputs and outputs

The following points may be noted in this regard:

1. It makes cross-checking of tax paid at earlier stage, more amenable, as dealers are required to state the amount of tax in invoices.
2. Tax burden being dependent upon the tax rate at the final stage, dealers at intermediate stages do not have any incentive to seek treatment in tax rate.

Under the invoice method, exports can easily be relieved of domestic indirect taxes through zero rating of exports.

Miscellaneous provisions

Treatment of export

For all exports made out of the country, VAT paid within the State will be generally refunded in full within a stipulated period (generally it is 3 months). Moreover, units located in SEZ and EOU will be generally granted either exemption from payment of input tax or refund of the input tax paid within the aforesaid period.

1. Merits and Demerits

MERITS

1. No tax evasion :

- 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.

2. Neutrality :

- 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.

3. Certainty :

- 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.

4. Transparency :

- Under a VAT system, the buyer knows, out of the total consideration paid for purchase of material, what is tax component.
- Thus, the system ensures transparency also.
- 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. Better revenue collection and stability :

- The Government will receive its due tax on the final consumer/ retail sale price.
- There will be a minimum possibility of revenue leakage, since 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.
- Thus, in particular, an invoice of VAT will be self enforcing and will induce business to demand invoices from the suppliers.
- Another attribute of VAT is that it is an exceptionally stable and flexible source of Government revenue.

6. Better accounting systems :

- Since the tax paid on an earlier stage is to be received back, the system will promote better accounting systems.

7. Effect on retail price :

- A persistent criticism of the VAT form has been that since the tax is payable on the final sale price, the VAT usually increases the prices of the goods.
- However, VAT does not have any inflationary impact as it merely replaces the existing equal sales tax.
- It may also be pointed out that with the introduction of VAT, the tax impact on raw material is to be totally eliminated.
- Therefore, there may not be any increase in the prices.

DEMERITS

1. In the federal structure of India in the context of sales-tax, so long as Central VAT is not integrated with the State VAT, **it will be difficult to put the purchases from other States at par** with the State purchases. Therefore, the advantage of neutrality will be confined only for purchases within the State.
2. For complying with the VAT provisions, **the accounting cost will increase**. The burden ofthis increase may not be commensurate with the benefit to traders and small firms.
3. Another possible weak point in the introduction of VAT, which will have an adverse impact on it is that, since the tax is to be imposed or paid at various stages and not on last stage, it would**increase the working capital requirements and the interest burden on the same**. In this way it is considered to be non-beneficial as compared to the single stage-last point taxation system.
4. 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, thisweakness is inherent in all the forms of consumption tax. While it may be possible tomoderate the distribution impact of VAT by taxing necessities at a lower rate, it is always advisable to moderate the distribution considerations through other programmes ratherthan concessions or exemptions, which create complications for administration.
5. As a result of introduction of VAT, the **administration cost to the State can increase** as the number of dealers to be administered will go up significantly.

2. Records under VAT

1. The following records should be maintained under VAT system:
   (i) Purchase records
   (ii) Sales records
   (iii) VAT account
   (iv) Separate record of any exempt sale
2. **Further, the following records should also be kept and produced to an officer:**
   (i) Copies of all **invoices** issued, in serial number;
   (ii) Copies of all **credit and debit notes** issued, in chronological order;
   (iii) **All purchase invoices**, copies of customs entries, receipts for payment of customs duty or tax, and credit and debit notes received to be filed chronologically either by date of receipt or under each supplier's name;
   (iv) **Details**of the amount of **tax charged** on each sale or purchase;
   (v) **Total of the output tax and the input tax** in each period and a net total of the tax payable or the excess carried forward, as the case may be, at the end of each month;
   (vi) Details of **goods manufactured** and delivered from the factory of the taxable person;
   (vii) Details of each supply of goods from the business premises, unless such details are available at the time of supply in invoices issued at, or before, that time;
3. **Failure to keep these records may attract penalty**. All such records should be **preserved for the period specified in respective State provisions.**

RETURNS

- Under VAT laws there are **simple forms** of returns.

- Returns are to be filed **monthly/ quarterly/ annually** as per the provisions of the State Acts/ Rules.
- Returns will be accompanied with the payment **challans**.
- Some States have devised **return cum challans**. In these cases the returns along with the payment can be filed with the treasury.
- A registered dealer may be required to file a monthly/quarterly/annual return **along with the requisite details such as output tax liability, value of input tax credit, payment of VAT** etc.
- Opportunity may be provided to lodge **revised returns**.
- Every return furnished shall be **scrutinized expeditiously** within the prescribed time limit from the date of filing the return.
- If any **technical mistake** is detected on scrutinizing, the dealer shall be required to **pay the deficit** appropriately.

Return filing procedures under VAT laws are designed with the objective of:

(i) **Reducing the compliance costs** incurred by the businesses in completing and filing their returns; and

(ii) Encouraging businesses **to comply with their obligations to file returns** and pay VAT through the application of penalties in case of late payment of VAT and late filling of returns; and

(iii) Ensuring the efficient processing of the data included in the returns.

ASSESSMENT

- The basic simplification of VAT is with **reference to assessment**.
- 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**.

System of cross checking:

- In the VAT system more emphasis has been laid on **self - assessment.**
- Hence, a system of cross-checking is **essential.**
- Dealers may be asked to submit **the list of sales or purchases** above a certain monetary value
- or to give the dealer-wise list from **whom or to whom the goods** have been purchased/sold for values exceeding a prescribed monetary ceiling.
- A cross-checking **computerized system** is being worked out
- on the basis of **coordination between** the tax authorities of the **State Governments** and the authorities **of Central Excise** and **Income-tax**
- **to compare constantly the tax returns and set-off documents** of VAT system of the States and those of Central Excise and Income-tax.
- This comprehensive cross-checking system will help **reduce tax evasion** and
- also lead to significant **growth of tax revenue**.
- At the same time, by protecting the interests of tax-complying dealers against the unfair practices of tax-evaders, the system will also bring in more equal competition in the sphere of trade and industry.

AUDIT

- In VAT system considerable weightage is placed on audit **work in place of routine assessment work.**
- **Correctness of self-assessment** will be checked through a system of **Departmental Audit**.
- A certain **percentage of the dealers** will be taken up for audit every year **on a scientific basis**.
- If, however, **evasion i**s detected in the course of audit, **the previous records** of the concerned dealer may be taken up for audit.
- **Authorized officers** of the department will **visit the business place** of the dealer to conduct the audit. The auditors will examine the **correctness of the returns**vis-a-vis the books of account of the dealer or any other information available with them.
- They will be **equipped with the information** gathered from various agencies such as suppliers, income tax department, excise and customs department, banks etc.
- Officers of the higher rank will supervise to ensure that the audiiwork is done in a free, fearless and impartial manner.

Accounts to be audited in certain cases :

- Under the sales-tax laws, tax evasion is considered to be on a large scale.
- The sales-tax departments of various States have not been able to effectively check the menace of tax avoidance and tax evasion.
- Therefore, apart from the departmental audit many States have also incorporated the concept of audit of accounts by chartered accountants.
- The State of Maharashtra has prescribed an elaborate list of particulars to be furnished by the dealers. These particulars have to be verified by the VAT auditor.
- However, auditing for all types of dealers may not be necessary.
- The selection of cases for auditing has to be made in accordance with the criteria of the size of dealers.
- In such a case, the returns supported by the audited statement can be accepted summarily.
- However, it might indeed be useful to cull out a fixed proportion of large and medium sized dealers for regular assessments on a regular basis.
- In Maharashtra and Rajasthan, the dealer whose turnover exceeds Rs.40 lakhs in any year is required to get his accounts audited in respect of such year.

PENAL PROVISION

Since VAT is purely a State subject, States will have incorporated penal provisions as per their requirements. However, these are in general more stringent than those in the earlier sales tax laws. Since, the State taxation laws have allowed certain additional benefits in the form of input tax credit, which was not available earlier, they have introduced more stringent penal provisions to discourage evasion of taxes.

DECLARATION FORM

No declaration forms:

Most of the declaration forms that existed before the introduction of VAT have been dispensed with. Use of declaration forms is expected to be stopped completely. Lot of time and energy is wasted by the dealer in getting declaration forms from the department.

There is no provision for concessional sale under the VAT Acts since the provision for set off makes the input zero-rated. Hence, there will be no need for declaration form.

ROLE OF CHARTERED ACCOUNTANT

Chartered Accountants have a key role to play in proper implementation of VAT.

(i) **Record keeping :**VAT requires proper record keeping and accounting. Systematic records of input credit and its proper utilisation is necessary for the success of VAT. Chartered Accountants are well equipped to perform such tasks.

(ii) Tax planning : In order to establish an efficient plan for purchases and sales, a careful study of VAT is required. A Chartered Accountant 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.

(iii) Negotiations with suppliers to reduce price : VAT credit alters cost structure of goods supplied as inputs. A Chartered Accountant will ensure that the benefit of such cost reduction is passed on by the suppliers to his company. However, if the buyers of his company make the similar demand, he must be ready with full data to resist the claims.

(iv) Handling the audit by departmental officers : There will be audit wing in department and certain percentage of dealers will be taken up for audit every year on scientific basis. Chartered Accountant can ensure proper record keeping so as 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.

(v) 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, return filed by dealer 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.

VAT laws of some States provide for audit by outside agencies. In Karnataka, audit report is required if turnover exceeds Rs. 25 lakhs. Andhra Pradesh VAT Act provides for audit by Chartered Accountant, if audit is ordered by Commissioner. Maharashtra VAT laws provide for audit by Chartered Accountant if turnover exceeds Rs. 40 lakhs. Other States may also prescribe external audit, once they see the utility of audit reports furnished by Chartered Accountant in ensuring tax compliance.

CROSS CHECKING

A comprehensive cross-checking system is a pre-requisite for an efficient VAT system as VAT system requires the assessees to self-assess the VAT liability and only a few returns are scrutinized on a selective basis.

A threshold limit for purchases/sales may be specified exceeding which the dealers may be asked to submit the list of purchases/sales or the dealer-wise list from whom or to whom the goods have been purchased/sold.

A cross-checking computerized system is being worked which would facilitate the comparison between the tax returns and set-off documents of VAT system of the States and those of Central Excise and Income-tax.

Cross checking reduces tax evasion which leads to significant growth of tax revenue. It protects the honest dealers and penalizes the fictitious or dishonest ones and creates a level playing field.