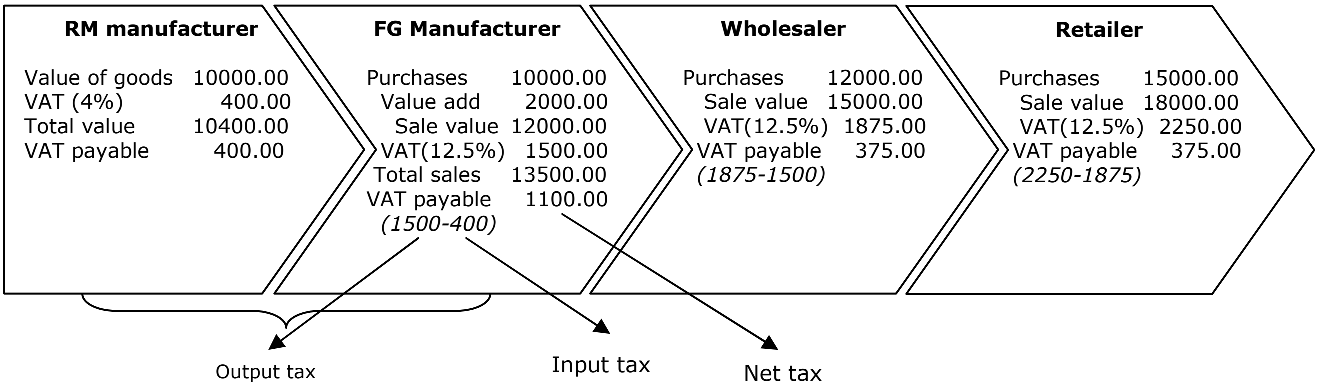
Value Added Tax

Unlike the prevailing system of commodity taxation, VAT aims to bring in visibility in both the value of goods and the scheme of taxation at each stage, make it self policing and usher transparency and to simultaneously do away with the cascading effect currently prevalent.

Broadly, VAT operates as follows:



Total VAT payable = 18000 * 12.5% = 2250
Total VAT paid = 400 + 1100 + 375 + 375 = 2250

Note: VAT rates:
(i) 4% when sold as inputs for use in manufacture or processing of other goods
(ii) 12.5% is the revenue neutral rate

The Empowered Committee of State Finance Ministers constituted by the Ministry of Finance, Government of India released the white paper on Value Added Tax on January 17, 2005 which elaborates on certain aspects of convergence which the State Governments are advised to build into their respective VAT legislations. Subsequently, certain other developments have taken place. Broadly, such issues of convergence and developments are:

- VAT law to include both manufacturers & traders
- To abolish all other existing levies like, turnover tax, surcharge, additional surcharge & special additional tax
- CST to presently continue and proposed to phase it out over a period of 2 years
- VAT to have only 2 basic rates, viz., 4% & 12.5%, with an exception to precious metals which will be taxed at 1% and demerit goods at 20%
- 10 out of 46 exempted goods to be State specific
- Entry tax if not subsumed into VAT to qualify for input tax credit
- States to follow invoice method for providing set-off of input tax/es
- Consignment transfer, warranty and such other transfer outside the State to disentail credit of VAT paid only upto 4% on inputs
- VAT paid on all exports to be refunded in full
- Excess of input tax lying unutilized at the end of year 2 to automatically qualify for refund
- Dealers with an annual turnover of less than Rs. 5 lakhs to remain out of VAT
- Dealers with an annual turnover not exceeding Rs. 50 lakhs may opt to pay upto 1% of the gross turnover in lieu of VAT under the composite scheme

Tax rate	**No. of commodities**
Exempt	46
4%	270
12.5%	280

- More than one type of invoice prescribed
- Different formats of invoices based on the nature of sale
- Formats of debit notes & credit notes prescribed
- VAT to do away with the system of assessment by the department and to follow procedure of self-assessment of tax liability
- Self assessments to go through a simple departmental audit
- VAT law to do away with the requirement of concessional forms unlike the prevalent sales tax laws
- '*Tax information exchange system*' is developed to track movement of goods across the State borders

At the outset, it appears very well with VAT envisaged to contain the above issues of convergence and that the same would remain identical across all the States.

However, what one has to consider under the VAT regime in the light of restricted input tax availability in case of stock transfers, continuance of CST for the next two years, negative list of goods which do not qualify for input tax credit, continuance of existing Sales Tax laws for certain specified products, availability of credit in case of capital goods over a staggered period, composition scheme for dealers whose annual turnover does not exceed Rs.50 lakhs are really the issues relating to suitability of sourcing & distribution patterns currently followed, impact on pricing of procurements & supplies, timing of purchase of capital goods, tax cost on purchases effected from dealers under the composite scheme, accounting of VAT as against CST paid on purchases, continued compliance under the existing Sales Tax laws & last but not the least, documentation insofar as it relates to, self-assessment matters & multiple uses of VAT paid goods.

Despite the concept of tax on value addition being as old as 1980's in India when it was introduced in form of MODVAT now called CENVAT; it is pertinent to note that India is now at a threshold to implement State VAT, which is a concept, new in itself, for both, the trade & industry and the State Governments. Unlike the CENVAT which covers only the manufacturing sector, the State VAT covers traders extending upto the retail sector.

With this and many more odds between Sales Tax and the VAT on one hand and between the VAT laws in different States on the other, it becomes essential for the trade and industry to ensure that transactions with high incidence of tax are identified and alternate business models are explored.

We believe that the trade and industry would have to simulate different models of sourcing and distribution to be able to arrive at a VAT efficient and VAT compliant business model. One step in this direction is to make available a simple, transparent and a result oriented simulation mechanism to the trade and industry.

VAT Simulator

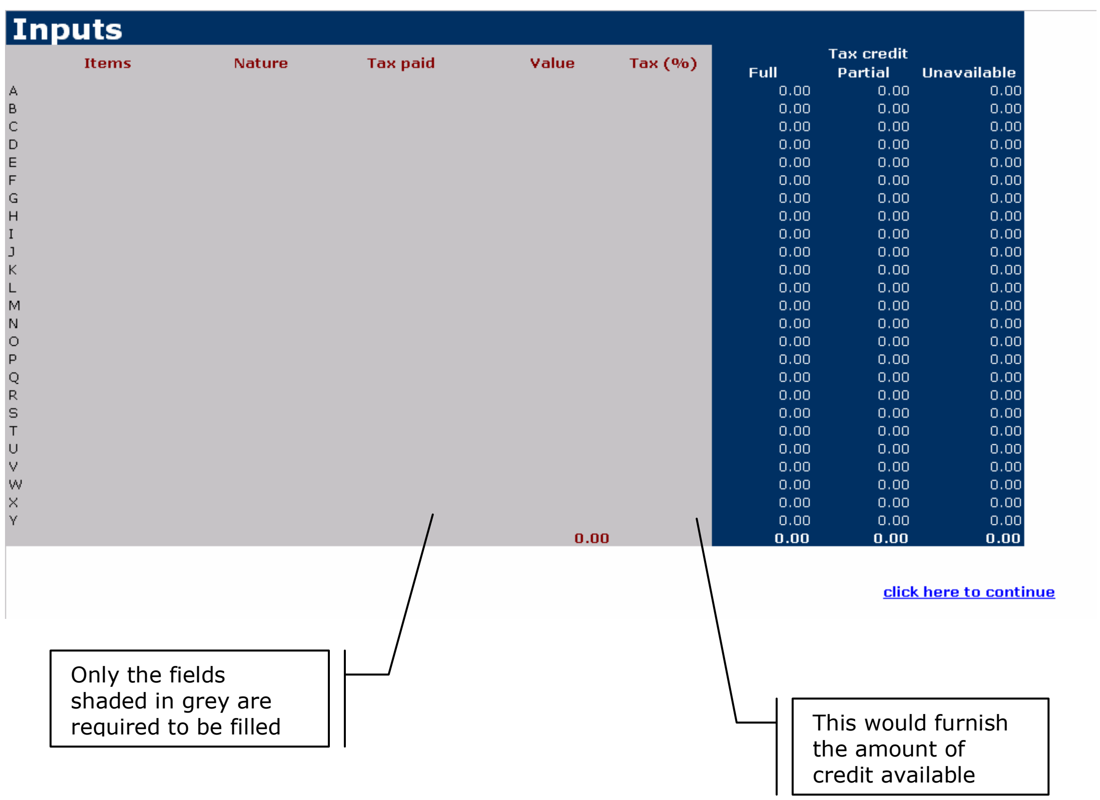
We believe that the trade and industry at large would not have access to high-end computer software and as such would not appreciate a simulation mechanism developed on an uncommon computer software platform. Thus, in a desire to reach out to the trade and industry, we have developed a simple, comprehendible and a transparent simulation mechanism which we believe would assist the management in identifying high tax incidence transactions and suggest alternate models of procurement and distribution with the differentials in tax cost, viz, VAT Simulator.

VAT Simulator is developed on Microsoft Excel and gives the user a ready impact of VAT on relevant transactions. It analyses the impact of the relevant transactions under the VAT regime and gives you the most optimal method of procuring and dispatching goods.

All it needs is some basic data of procurements and distribution for a specified period.

The VAT Simulator has has six (6) worksheets. The details of the same are:

1. **INPUTS**: The details relating to purchases made during the relevant period are required to be indicated here.



Inputs

	Items	Nature	Tax paid	Value	Tax (%)	Tax credit Full	Tax credit Partial	Tax credit Unavailable
A						0.00	0.00	0.00
B						0.00	0.00	0.00
C						0.00	0.00	0.00
D						0.00	0.00	0.00
E						0.00	0.00	0.00
F						0.00	0.00	0.00
G						0.00	0.00	0.00
H						0.00	0.00	0.00
I						0.00	0.00	0.00
J						0.00	0.00	0.00
K						0.00	0.00	0.00
L						0.00	0.00	0.00
M						0.00	0.00	0.00
N						0.00	0.00	0.00
O						0.00	0.00	0.00
P						0.00	0.00	0.00
Q						0.00	0.00	0.00
R						0.00	0.00	0.00
S						0.00	0.00	0.00
T						0.00	0.00	0.00
U						0.00	0.00	0.00
V						0.00	0.00	0.00
W						0.00	0.00	0.00
X						0.00	0.00	0.00
Y						0.00	0.00	0.00
				0.00		0.00	0.00	0.00

2. **DISPATCHES**: The details relating to distribution of goods made during the relevant period are required to be indicated here. The details of stock transfers and other non-sale dispatches would also required to be indicated.

Dispatches

	Items	Nature	Value	Tax (%)	Buyers' tax Cost	Buyers' tax Credit
A					0.00	0.00
B					0.00	0.00
C					0.00	0.00
D					0.00	0.00
E					0.00	0.00
F					0.00	0.00
G					0.00	0.00
H					0.00	0.00
I					0.00	0.00
J					0.00	0.00
K					0.00	0.00
L					0.00	0.00
M					0.00	0.00
N					0.00	0.00
O					0.00	0.00
P					0.00	0.00
Q					0.00	0.00
R					0.00	0.00
S					0.00	0.00
T					0.00	0.00
U					0.00	0.00
V					0.00	0.00
W					0.00	0.00
X					0.00	0.00
Y					0.00	0.00
			0.00		**0.00**	**0.00**

click here to view net tax computation

Only the fields shaded in grey are

This would furnish the amount of output tax and the cost of purchase for the customers due to non-

3. **NET TAX**: The next worksheet is self-explanatory and furnishes the amount of net tax payable by the dealer.

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4. **TAX-COST INPUTS**: The CST paid on inter-State purchases would does not *perse* qualify as credit under the VAT law. Consequently, one has to check for options to source the same locally. This worksheet calculates the impact of such transactions on the net cost of tax under two alternates, (i) what if these goods are procured locally within the State from another supplier, or (ii) What if the same supplier agrees to make such goods available locally *(within the State)*. The envisaged amount of inter-State purchases that could be replaced with any of these two options would be analysed in the light of its impact on the cost of tax to the dealer. A snapshot of details furnished in this worksheet on certain hypothetical transactions is furnished below.

Inputs

Value	Tax	Total	
200,000.00	8,000.00	208,000.00	**take a look at this sheet...**

To be able to avail credit on such purchases: options:
1. Source the goods locally
2. Get the same supplier to make a local sale

Option 1

How much of inter-State purchases do you wish to replace with local procurements? ----->	120,000.00	
What would be the estimated value of such purchases? ----->	125,000.00	
What is the VAT rate on such goods? ----->	12.50%	
Value of goods on account of current inter-State purchase		200,000.00
Current tax cost		8,000.00
Estimated replacement of inter-State purchases with local procurements		120,000.00
Current tax cost on such inter-State purchases		4,800.00
Cost of goods (without any tax credit)		**124,800.00**
Value of goods on account of estimated local purchase		125,000.00
Amount of tax payable		15,625.00
Cost of goods (net of VAT credit)		**125,000.00**
Evaluation	***additional burden***	**200.00**
		bad option, try the next one...

Option 2

What would be the estimated value of such goods? ------->	124,000.00	
What is the VAT rate on such goods? ------->	12.50%	
Value of goods on account of current inter-State purchase		120,000.00
Current tax cost		4,800.00
Cost of goods (no tax credit)		**124,800.00**
Value of goods on account of estimated local purchase		124,000.00
Amount of tax payable		15,500.00
Cost of goods (net of VAT credit)		**124,000.00**
Evaluation	***reduction in cost***	**-800.00**
		good one... check the table below

Comparitive table - cost of goods

Current structure	124,800.00
Option 1	125,000.00
Option 2	124,000.00

click here to compare inter-State sales with stock transfers

Note:
Only the details indicated in the circles above are to be furnished based on which the other details are calculated and a comparative statement furnished at the bottom of the worksheet. The net cost of goods furnished at the bottom of the worksheet would assist in identifying the optimal nature of purchase.

5. **TAX-COST DISPATCHES-IST**: Similar to the analysis of the purchase model, this worksheet analyses the impact of making an inter-State sale to the customer as against making a stock transfer to the customer's State and making a local sale to him therefrom. In such circumstances, the dealer would be disentitled to claim credit on inputs upto 4%. This worksheet identifies the appropriate amount of loss of input tax and compares the same with the estimated amount of gain in selling price. A snapshot of details furnished in this worksheet on certain hypothetical transactions is furnished below.

Dispatches

Nature	Value	Tax	Total
exports	0.00	0.00	0.00
inter-State	250,000.00	10,000.00	260,000.00
local	125,000.00	15,625.00	140,625.00
others	0.00	0.00	0.00
stock transfers	300,000.00	0.00	300,000.00

take a look at this sheet....

inter-State

- tax credit fully allowed on inputs, no cost on sales		Nil
- to be borne by the buyer since CST is not allowed as credit		10,000.00
Option		
- to stock transfer and make a local sale in the State of the customer		
Value of inter-State sales you wish to replace with stock transfer model	--->	200,000.00
What would be the estimated selling price under this model?	--->	215,000.00
Particulars		
Current cost of CST to the buyer for the estimated replacement		8,000.00
Additional dis-allowance of input tax due to non-sale dispatches *(if the option is exercised)*		1,207.73
Cost of the purchase to the customer		
In the current model		208,000.00
Under this proposed model		215,000.00
Net benefit derived		
Change in selling price		15,000.00
Proportionate dis-allowance of input tax		-1,207.73
		13,792.27

stock transfer looks promising...

Note:
Only the details indicated in the circles above are to be furnished based on which the other details are calculated and the impact of this simulation is furnished.

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6. **TAX-COST DISPATCHES-STKTRF**: Similar to the computation in the previous worksheet, the impact of replacing the current stock transfer with an inter-State sale is analysed. The computation in this worksheet would be the reverse of what is done in the previous worksheet. The gain of input tax credit on account of reduction in stock transfers is compared with the cost of CST to the buyer.

These calculations, we believe would assist the trade and industry to assimilate the impact of VAT on the envisaged transactions and would provide a basis for the decision making.

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