

VAT in India—Issues and Concerns



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Almost three-fourths of India has adopted Value Added Tax regime, switching off its age-old sales tax system that had existed for more than 50 years. While this change is a welcome measure for the trading community at large, the change-over would be a success only when the same is implemented across the country. This article analyses some of the major issues and concerns arising out of this so-called fractured implementation of VAT.



The much talked-about tax reform— Value Added Tax (VAT) that replaces the existing Sales Tax structure across various states has at last come to stay in majority of the states in India, thanks to the efforts of Mr. Asim Das Gupta, the Chairman of the Empowered Committee (EC) of State Finance Ministers. After several rounds of discussions and meetings to arrive at a consensus on various issues concerning the trade and industry at large, the EC has started its first phase of implementation in various states. Though, the White Paper on the State Level Value Added Tax released on the 17th of January 2005 has talked about various decisions which the EC has agreed upon, it is not out of place to mention that not all problems of the trade are addressed to in the same. The discussions after the

release of the White Paper also solved certain issues like a definitive time frame for the removal of the Central Sales Tax (CST). However, this article critically examines the issues causing concern for trade and industry due to the so called fractured implementation of the VAT in India, where some states follow VAT regime while some others stick to the age old sales tax system.

Fractured Implementation and Its Effects

The proposal to integrate the various indirect taxes across the country, by evolving a uniform Goods and Service Tax (GST), as recommended by the Kelkar Committee, would be possible only when there is a uniformity in the taxation system. This is because the uniformity itself will lead to smooth transition

to an integrated GST. However, due to certain political and other considerations, some of the states have not joined the bandwagon of VAT that came into force w.e.f 1st of April 2005. This will create problems, some of which are listed as under:

1. Differential tax treatment: While the states following the VAT regime allow the credit of all the taxes paid at an earlier stage (subject, of course, to certain restrictions), against the final tax liability, the states following the sales tax still follow the single point levy, exempting subsequent stages of sale/imposing another tax by various names such as resale tax, turnover tax, etc. This may lead to a situation, where a business unit having its business spread across the country would not be able to maintain a uniform pricing system.

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Also, the margins of various businesses would get affected due to this indifference.

2. Movement of goods: Where the goods move from a VAT state to a non-VAT state, the credit of locally procured materials would be available against the Central Sales Tax that is required to be paid. On the contrary, movement of goods from a non-VAT state to a VAT state would not be able to set off its tax paid on the purchases, which would obviously result in a position that the customer would be required to bear an additional brunt of tax in this case.

Though the VAT acts allow the set off of tax paid on the inputs in excess of 4% in case of stock transfer of goods, the same would not be useful in case where the goods are transferred from a non-VAT state, where similar provisions do not exist. Hence, the stock transfers from VAT states would bear a less tax burden compared to the transfers from a non-VAT state. However, the impact would also depend on the prevailing sales tax rate because in a case of sales tax rate being less than 4%, the same would not affect the stock transfers.

3. Phasing out of CST: It has been agreed that the CST would be phased out completely by 2007. The Government needs to be firm on this decision as this is an area, which is presently hurting the business segment. With the CST not being allowed as a credit, all the business units need to find a local sourcing of materials for a temporary period of two years (as it stands today), which would not be possible for many traders who have been dealing on inter state purchases for the last several years. The major decisions such as changing the

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sourcing person would not also be worth as the existence of CST is only for a limited period from now. Hence, till the time the CST is phased out, the additional burden of tax has to be borne by the ultimate consumers. This also results in a competitive advantage to the businesses, which completely depend on local supplies against a business having multi fold sourcing from various parts across the country.

4. Incentive Schemes: With the decision of the implementation of the VAT, all the State Governments have put the incentive schemes aside. All the businesses, which were granted the benefits of various incentive schemes, need to find a way out to sustain and survive, as all their financial projections need to be adjusted so as to suit the requirements of the current legislations across various states. This will also lead to another problem in cases where the unit having businesses across the country in states that are imposing VAT and states not imposing VAT, such as there could not be uniformity in the pricing system.

5. Exemption Schemes: As the basic idea of VAT is to ensure uniformity across various sections, it is imperative that there should not be any schemes permitting exemptions for specific dealers. This would result in a situation where the VAT chain breaks in between in case there are dealer specific exemptions, as they exist today. This would also affect the supplies made to the various exempted units such as Canteen Stores Department. All the Charitable Institutions which were earlier granted exemption under the Sales Tax regime need to gear up to comply with the new tax regime attracting for the first time and following the updated legislations, which would be a cumbersome process given the nature of the businesses being carried out by them. The so called fractured implementation would now make the VAT states as less competitive compared to non VAT states, as they would not be in a position to avail any of the exemption schemes.

6. Accounting Systems: The fractured implementation of VAT basically affects the companies following a uniform and centralized accounting system in an Information Technology environment. This is because of the fact that the accounting treatment differs in a VAT regime when compared to a non-VAT regime. When these both co-exist, the problems on account of maintenance of books of account would be innumerable as it would be difficult to keep a trail of events that would be necessary in order to avail the full benefits accruing under a VAT system.

7. No Uniformity in the rates: Even among the states that have implemented the VAT, there is no uniformity in the rates that is being

followed. As one could see, the Empowered Committee covered only 550 commodities in two schedules of 4% and 12.5% VAT, leaving out many items and more products to the whims and fancies of State tax administration. Also, the current rates as proposed by the White Paper, which were now implemented differ with the rates existing in the State of Haryana, pioneer state in introducing the VAT in the year 2003 itself. There are three rates existing in Haryana i.e. 4%, 10% and 12.5%. However, the states, which have implemented the VAT, now have only two rates namely 4% and 12.5%. There are certain critical items where there is a wide disparity in the rate of taxes across neighbouring states. In order to maintain uniformity all over India, rates of VAT are required to

be decided by the Empowered Committee and applied in all the states and Union Territories. Adoption of a uniform system like that of a Harmonised System of Nomenclature (as is in force today for the Central Excise and Customs purposes) would be convenient for all the states to comply with. This type of uniform system is bound to reduce considerable litigation, which could be on various matters relating to classification of goods.

Conclusion

The move towards the VAT regime is a welcome step for the Indian Economy, but to get the complete benefits of this VAT, it is necessary that the whole nation should understand the issues and concerns of the trade and the industry at large in

evolving a common system of taxation across the country. The states, who have not yet implemented the VAT, have to understand the problems being faced by the trading community at large and should implement the VAT as quickly as possible so as to reduce the concerns of trade. This would pave the way for initiating the steps for the introduction of the GST in a near future.

As already steps have been initiated in integrating the taxation on goods and services at the central level (already inter sectoral credit has been introduced), it would be necessary to initiate the steps for ensuring a uniform value added tax law across the country which would then pave the way for implementation of a common GST across the country. ■

MEMBERSHIP FEES

Membership and Certificate of Practice fee for the Year 2005-2006

Annual membership fee and certificate of practice fee is payable on 1st April, 2005. The schedule of fee is as under:

Associate Membership Fee	Rs. 300	Fellow Membership Fee	Rs. 900
Certificate of Practice Fee	Rs. 800		

Individual circulars are being mailed to members giving details of scale of fee and also the manner of deposit/remittance of the fee. For the convenience of the members the fee would also be accepted in designated branches of the Central Bank of India in the specified cities. The fee can therefore, be remitted either to the concerned Decentralised Office of the Institute or in the designated branches of the Central Bank of India in the challan enclosed to the individual letters being sent to members during March, 2005.

A data sheet giving some of the particulars of the member concerned as they appear in the Institute's database is also being sent for their verification and confirmation. The data sheet may be verified by the member and also returned to the Decentralised Office concerned by 30th April, 2005. If data sheet is not received by 30th April, 2005, particulars appearing therein would be taken as confirmed for publication in the List of Members AND list of Firms as on 1st April, 2005, which is proposed to be brought out by 15th May, 2005. Also enclosed with the above communication is a blank specimen signature card for specimen signatures of the member for Institute records. It may be noted that remittance of fee has to be made by local cheque (in the case of members who are residing in the cities in which respective Decentralised Office is situated or designated branches of the bank exist) or by way of demand draft in favour of "Secretary, The Institute of Chartered Accountants of India" payable at the place where the concerned Decentralised Office of the Institute is located. It may also be noted that under no circumstances out-station cheques will be accepted. No remittance should be made directly to the Head Office or a different Decentralised Office. The designated branches of the bank would not accept remittance made through post. Members can also pay fee in advance in accordance with the details given in the communication being mailed to the members.

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In order to avoid the process of removal of name and/or cancellation of certificate of practice on account of non-payment of fee members are advised to remit the fee by 30th April, 2005.