The success stories of Value Added Tax in 130 countries and the advantages of shifting towards VAT regime are already in the limelight. But not much is being said on the way we have inherited a fractured VAT. This article attempts to discuss the so perceived gray areas of White Paper of VAT, the issues yet to addressed, features of VAT in 130 countries, Haryana, and the fear of traders and the steps initiated to stabilize the VAT regime

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IS TRUNCATED VAT A BETTER OPTION?

Any Tax reform is welcome, but there should not be strong consensus for weak reforms. The experience with reforming the domestic trade taxes is a clear example of how little economic considerations matter in political decisions. After all, it was the NDA government that pushed the VAT agenda when it was in power, though it developed cold feet towards the end to satisfy the traders' lobbies.

Gray Areas in White Paper

The Empowered Committee has on 17th Jan, released a white paper detailing justification for a switchover to VAT regime, the main design of VAT, and issues relating to effective implementation thereof.

1. White paper is an official memorandum issued by the Government in which a problem and various considerations bearing on it are set out and the policy, which the Government advocates or is disposed to advocate is stated. The White Paper under consideration hardly fits into this definition. In other words it has no Constitutional or legal sanctity.
2. Immediately after the release of White Paper, the Uttar Pradesh brought an ordinance to introduce TOT of 1% w.e.f 25th January 2005 and Andhra Pradesh proposed to levy CESS on Excise and Sales Tax for funding irrigation projects. Such steps, due to federal flexibility and freedom being enjoyed by each state for appropriate variations to suit their specific needs, jeopardise the spirit of White Paper and also send a signal that White Paper need not be followed by states who are party to overall consensus in its letter and spirits.
3. Sales Tax laws prevailing in our states are as old as our freedom. Umpteen attempts have been made to revise them to suit the economics of the States. Resultantly such laws have attained reasonable stability

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and the business community by and large, has come to terms with these laws. All the Finance Ministers have now agreed that the prevailing tax structure in their states was not only defective but was beyond correction.

4. The White Paper says that under VAT there will be self-assessment by dealers. The paper attempts to sound as if the tax administration would accept whatever is intimated to them, without any thing more. The sweeping powers given in each state to the department will ensure that the plight of taxpayer does not end on his filing a correct and complete return of tax. In most of the states, the availability of declaration forms under CST Act, 1956 is a question mark and there is a price tag for obtaining blank forms from the department. In Delhi, being the Capital of India has set out 14 commandments to get blank forms. Since CST assessments are also being covered under "Self assessment", the problems of the dealers in getting the forms will get multiplied. There is also a proposal to replace the present system of issuance of one C form for the entire one financial year into quarterly basis. This will further aggravate the woes of the dealer in facing self-assessment.
5. Surprisingly there is no mention in the White Paper on "Deemed Sales" and also the procedure for goods covered under MRP regime. Each state is coming out with different types of composition scheme under Works Contract and non-composition route based on Supreme Court's guidelines in Gannon & Tunkerley (88 STC 270), which results in rate war and unhealthy competition trend. The methods adopted as per the apex court's guidelines for discovering the price of transfer of goods in a Works Contract by a works contract dealer are always disputed by the department resulting in disallowance of legitimate claims. West Bengal has come out with an innovative way of working out works contract liability under non-composition route by adopting "contractual transfer price " instead of working out from the value of the total contract.

Unaddressed Issues

The proposed reforms have following important shortcomings.

1. **Continuance of CST under VAT regime:** CST is not made VATable. Continuance of the CST on the basis of "origin" is inconsistent with VAT. It is going to cost the consumers more in the importing sates unless the manufacturers have the capacity to absorb the tax incidence. It is necessary to have a clear roadmap for abolishing the Central Sales Tax (CST) and the same cannot co-exist along with State VAT. A clear decision in this regard is necessary and it is important to work out with modalities either through zero rating or a clearinghouse mechanism, or a compensatory VAT. Continuation of the CST, even for a shorter period of two to three years, seriously undermines the benefits of VAT in rationalizing the supply chain management and removing distortions in inter-state movements of goods. Once CST is abolished, the first point of levy will be at the manufacturing stage. In such a scenario all investment decisions will largely depend upon genuine criteria like availability of raw material, skilled labour and quality of infrastructure available in the state. This would be an ideal scenario for overall growth and investment in the country, which will make the Indian industry cost competitive. The Input Tax Credit restriction on stock transfers/consignment sales should be in line with phasing out rate of CST.

> **For international pricing, we need to move towards integrated tax regime call it GST or by any other name. Today, the taxes/duties that coexist and grossly affect the direct foreign investments and cost efficiency of domestic manufacturers include, Excise Duty, Service Tax, Customs Duty, Octroi, Central Sales Tax and Sales Tax on demerit goods, presently not VATable**

2. **Sweeping powers given to Commissioners:** The legitimate fear of dealers is that of harassment by the official. Today the main reason of India having poor Revenue GDP ratio is on account of the fact there is gross mistrust between the department and the dealer. If the relationship is not built on trust, it will breed the corruption and evasion attitude. What is really

needed in India is not the tax reform but tax administration reform. Unless the mindset is changed towards 'Trust", "transparency", this reform can never become popular and we have to keep on saying 130 countries have successfully implemented VAT and India is yet be on board. It is important for all tax departments to clarify and more so, demonstrate that VAT does not involve greater interface of taxpayers with tax officials and a critical element of reform is in moving over to information based system of administration in which self assessment plays a critical role. Even in the cases of detailed audit, it is necessary to lay down the ground rules.

The White Paper clearly says that penal provisions should not be more stringent than existing State Sales Tax Acts. But if we look into the powers conferred on the tax officials, the some of the enabling provisions take away the little smile on the face of the dealer after the introduction of VAT. For e.g., in Maharashtra there is an enabling provision that Commissioner can declare any commercial agreement/contract entered between a dealer and his client as null and void, if he is of the firm opinion that the provisions of the said contract are prejudicial to the interest of the Revenue. If such provisions are not removed at once, even legitimate tax planning can come under scrutiny and become vulnerable for disallowance.

3. **Poor quality of adjudication orders:** For successful VAT, all 130 countries have revamped their judicial systems in such a way it has changed the style of functioning and ensure the deliverables are of highest quality. In India, this issue is not suitably addressed yet. Cases are adjudicated by Commissioners/ Addl. Commissioners/Jt commissioners/Dy. Commissioner/ Asstt. Commissioner depending upon the monetary limits prescribed to them. Majority of these officers are totally not inclined to pass a correct order or to follow the settled position of law. The higher the tax demand, the surer one can be of confirmation. Though the Commissioner (Appeals) is holding a solemn office and is expected to uphold the law, they have found it convenient to uphold orders passed by their subordinates. In order to ensure effective implementation of VAT, the present judicial system needs a complete revamping.

4. **All States are not adopting VAT:** It is very unfortunate to see the development in the tax reform. Some states are not agreeing to come on board for introduction of VAT – a fiscal innovation in the country. As a sovereign nation, we might cavil at China's designs, and ambitions, but we cannot deny their desire and quest for greatness. With all their faults, they pursue their goals relentlessly. Our record is pathetic.

We in India have adopted only a few of the broad internationally accepted principles. VAT is an integrated tax across all levels while in India the move is still towards a state-level VAT. VAT figure in India does not represent the total Indirect Tax impact.

- The question that comes up in our mind is how are we better off in the competition field when customer prefers to buy materials/machinery directly from foreign countries as against domestic purchases and also the manufacturer is located both in VAT states as well as non VAT states. The logical conclusion from the following table is, sourcing machinery/materials directly from the VAT state manufacturer still ranks better. This confirms that VAT has inherent advantage which all states need to embrace sooner or later to develop a common market and internationally cost competitiveness. But for international pricing, we need to move towards integrated tax regime call it GST or by any other name. Today, the taxes/duties that coexist and grossly affect the direct foreign investments and cost efficiency of domestic manufacturers include, Excise Duty, Service Tax, Customs Duty, Octroi, Central Sales Tax, Sales Tax on demerit goods, presently not VATable.. The inverted duty structure system and preferential duty concession to PSUs also add to the woes of private sectors and making the survival more and more difficult.

The main objective of a uniform VAT is to integrate all taxes and also to do away with multiplicity of taxes. The success of the tax reform lies in how quickly we embark on this and integrate all taxes. But it is easier said than done.

Supply Order For Machinery / Equipment Supply To Client's Plants In Maharashtra, Gujarat & Karnataka: Imports Vis A Vis Indigenous Manufacture

Parameters :

1 Customs Duty Paid On Import Of Inputs And Final Product Will Be A Direct Charge To Cost Since Not CENVATABLE
2 CVD & ED Paid On Inputs And Final Products Will Not Have Any Cost Impact Since These Are CENVATABLE
3 VAT Paid On Inputs & Final Products In Vat States Will Also Have No Cost Impact Since These Are 100% VATABLE.
4 Sales Tax Paid On Inputs & Final Products In Non Vat States Will Be A Direct Charge To Cost Since The Taxes Paid Cannot Be Claimed As "Set Off ".
5 CST Paid On Inputs & Final Products Will Be A Direct Charge To Cost Since Not Vatable In VAT / Non VAT States

	Maharashtra [VAT State]			Gujarat [Non - VAT State]			Karnataka [VAT State]	
	For Inputs	For Final Products		For Inputs	For Final Products		For Final Products	
		Mfg & Sold In Mah.	Imported By Customer		Mfg &Sold In Guj	Imported By Customer	Mfg In Mah.	Imported By Customer
Duties/Taxes Leviable	(When Imported)			(When Imported)				
Custom Duty	15%	N.A.	15%	15%	N.A.	15%	N.A.	15%
Cvd @ 16% - (No Cost Impact)	16%	N.A.	16%	16%	N.A.	16%	N.A.	16%
Addl. Cvd @4% - (No Cost Impact)	4%	N.A.	4%	4%	N.A.	4%	N.A.	4%
Net Impact Of Duty On Cost Of Final Product			15%			15%		15%
	(Domestic Procurement)			(Domestic) Procurement				
Central Excise Duty (No Cost Impact)	16%	16%	N.A.	16%	16%	N.A.	16%	N.A.
Sales Tax - (Non VAT State)	N.A.	N.A.	N.A.	12% To 15 %	8%	N.A.	N.A.	N.A.
VAT (Iron & Steel) (No Cost Impact)	4%	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
VAT - (Non-Iron & Steel) (No Cost Impact)	12.50	4%	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CST (Cost Impact)	4%	N.A.	N.A.	4%	N.A.	N.A.	4%	N.A.
Net Impact Of Duty/Taxes On Cost Of Final Product		Nil Vis-À-Vis 15% On Imports			8% LST Vis-À-Vis 15% On Imports		4% CST Vis-À-Vis 15% On Imports	

From the above table, it can be seen that it is advisable for the purchaser (Customer) to buy the Machinery Equipment from the Domestic Manufacturer in the 3 States as Under:

- In Maharashtra Imports will be costlier because of 15% Custom Duty Impact on Cost as against Nil Duty/Tax Impact on Cost when procured locally.
- In Gujarat Imports will be costlier because of 15% Custom Duty Impact on Cost as against 8% Local Sales Tax although there being no Set Off.
- In Karnataka Imports will be costlier because of 15% Custom Duty Impact on Cost as against 4% CST although there being no Set Off.

In summation, procuring the Machinery/Equipment from Domestic Manufacturer will always prove to be Cost advantageous rather than importing the same.

VAT in 130 countries

VAT as applied in many countries and originally conceived of is a uniform levy centrally administered. It is primarily important to comprehend the fact that the very term "state level VAT" itself is self-contradictory. It is not a state levy tax in other countries. Let us see here the VAT design in those countries where VAT is proved economically successful:

- ➢ Goods and Services Tax
- ➢ VAT refund on inputs
- ➢ No VAT on Exports
- ➢ Tax on imports
- ➢ VAT refunds on bad debts
- ➢ VAT refunds on goods taken outside the country (by consumers)

➢ Issue of VAT invoices to the customers.

We adopted a few of the above broad principles. VAT is an integrated tax across all levels while In India the move is still towards a state level VAT. VAT figure in India does not represent the total Indirect Tax impact.

- **UK**: Standard Rate 17.50% & Reduced rate is 5% = Domestic fuel and power and 0% on food, books and newspapers, public transport, children clothing, new housing and pharmaceuticals.
- **Argentina**: Standard Rate 17% & reduced rate is 10.5% for gold and silver, some computer equipments photographic and medical equipment and honey
- **Australia**: has a 10% goods and service tax – services of in- bound tour operators are zero-rated.
- **China:** Standard rate is 17% - Reduced Rate of 6% (in some cases 3%) on microchips. Diamonds traded on the Diamond Exchange are VAT exempt.
- **France:** Standard rate 19.6% - reduced rate is 5.5% on food, public transport, pharmaceuticals, books, fast food /takeaways. VAT on news paper is 2.1%
- **Germany:** Standard rate 16% & 7% on food, books newspapers and local public transport
- **Spain:** Standard rate 16% & 7% applies to food, water supplies, renovation & repair to private homes, hairdressing and public transport. There is also 4% tax on basic foodstuffs, books, newspapers, pharmaceuticals and rental of certain houses.
- **Poland:** Standard rate 22% & Reduced Rate 7% on cable and digital TV providers & 3% on unprocessed agricultural products.
- **Zambia:** Rate is 17.5 %. Exemptions for insurance deals, mosquito nets and insecticides.
- **Vietnam:** Export of goods, computer software services & the repair of equipment and machinery are zero-rated.
- **Tunisia:** Standard rate is 18% & reduced rate is 10% on Internet connections and imported school notebooks.
- **Namibia:** 15% Standard rate – education, medical services, domestic accommodation, public transport and perks exempt from VAT. Sale of livestock, improvements to existing property are zero rated .

Under the present system, the dealer can still make profit out of tax whereas Value Added Tax System prohibits such a kind of practice. This may be one of the true fears of trading community in opposing the Valued Added Tax regime in India.

VAT in Haryana

Haryana had introduced VAT w.e.f 1.4.2003 without moving the bill for Presidential consent. The rates introduced in the VAT law were not in conformity with what is now proposed by the Empowered committee. Haryana is yet to amend the VAT law and rules in line with white paper. The documentation procedure, preservation of records, filing of VAT returns is not simplified but the old methodology adopted under earlier tax regime is being followed. The good thing what Haryana has done is, the credit on input tax in closing stocks was given back to dealers without any documentary compliance. The lower rate of composition offered by the states to dealers/retailers made the scheme attractive and also lured many dealers for voluntary registration. But the real success can be measured when the law is amended and brought on par with other VAT states.

The Fear of Dealers

Whether Tax evasion: The main reason for the opposition of VAT by the traders is said to be the large-scale evasion of sales tax by them. Once the data about sale and purchase of goods by the traders is available, they will not be in a position to escape from the levy of VAT. This viewpoint cannot be generalized. More than 80% of State revenue is collected through sales tax and that too from the trading community and to presume that all of them are tax evaders is not fair. Some of them may be resorting to evasion of sales tax but the benefit of tax evasion is passed on by them to the consumers in order to be more competitive. This may be one of the reasons but not the only reason for opposition of VAT by the trading community.

Disclosure of Margin of Profits: The traders are required to declare their purchase price for claiming input tax credit and they are required to declare their sale price as VAT is calculated on end price. They have fear about disclosure of their margin of profit. In normal circumstances no trader will prefer to make his margin of profit known to the others.

Under the present system, the dealer can still make profit out of tax whereas VAT system prohibits such a kind of practice. This may be the true fear of trading community in opposing VAT. The following example clarifies this issue better:

Compliance Cost: There is a gen-

TRADERS				
		Present system		VAT
Sale from Mfg				
	Cost	100		100.00
	Sales tax	16		12.50
	Total purchase cost	116		112.50
2nd sale			Less ITC	12.50
		116		100.00
	Margin		Margin	
	Say 20%	23	Say 20%	20.00
	Sale price	139		120.00
	Margin on sale tax	3.2		NIL

uine fear in the mind of traders that with the implementation of VAT, the documentation will increase many-fold. The traders and retailers buy the goods from wholesalers/dealers who supply the goods at their premises and collect the money. The dealers recover sales tax from the traders. The retailers take the purchase price as their cost, add their margin of profit and sale the goods. At present, they do not bother for maintenance of purchase bills as well as sale invoice/cash memos. At the end of the month, they approximate their sales and deposit applicable Sales Tax. This system is functioning smoothly all over India. The trading community has apprehension that with the implementation of VAT, they will be required to maintain all purchase bills and also to issue cash memo/sale invoices for each transaction. It would require an additional working hand and would add to their costing. The main worry of the trading community is the cost of compliance.

Continuous stocktaking: Another anxiety for trading community is the need of continuous stocktaking. The details of stocks as on 31.03.2005 and purchase documents will be required for taking input tax credit. Since purchase bills for past stocks have not been procured and maintained by them and no records of item wise sales are maintained, they will be required to undertake physical stock taking. Traders feel that the tax authorities will not allow input tax credit of inventory stocks without supporting documents.

Inter-State Transfer: The another issue is Inter-state transfer of goods in case of sale of the goods to another states, they will be required to pay Central Sales Tax without availing any benefit of input tax credit and the buyer at another end will also not be allowed to take credit of amount of CST. It will affect their inter state sales significantly.

Phasing out CST: As per pronouncement by the Empowered committee, they will review the Central Sales Tax during 2005-06, and suitable decision on phasing out of CST will be taken. The trading community has a feeling that Central Sales Sax, which accounts for revenue collection of Rs. 15,000/-crores per annum will never be abolished.

Abolition of other Taxes: It is announced that with the implementation of the VAT, Turn over Tax, Surcharge on Sales Tax, Additional Surcharge etc. will be abolished but the VAT Bills of States do not contain any clause to delete relevant Acts empowering State Governments to collect these taxes. The trading community has apprehension about continuity of such taxes in future also. Similar position is regarding Octroi, Entry tax etc., it is not known as to whether these taxes will be abolished or will continue.

Enforcement Powers: Another fear in the mind of trading community is regarding the powers proposed to be given to the tax authorities. Delhi VAT Bill, 2004 contains chapter-XIII (Section 86 to Section 94), which provides for wide powers to the tax authorities to impose fine, penalty and other stringent measures. In the proposed VAT Bill, Section 78 provides that the burden of proof is upon the traders and not upon the persons alleging tax evasion. Due to these provisions, the trading community fears harassment in the hands of tax authorities.

Exemption to small traders: Regarding the exemption to the traders with gross annual turnover up to Rs.5 lakh, they have anxiety that their declarations will not be accepted unless purchase bills, sale invoices, stock registers etc. are maintained. It is not possible for a small trader to maintain all such records.

Composition scheme: The Composition Scheme provides for a facility of payment of VAT @ .25% without taking input tax credit into consideration to those dealers who have turnover between Rs. 10 lakh and Rs. 50 lakh per annum. The traders have fear that their declarations will not be accepted unless purchase bills, sale invoices, stock registers etc. are scrutinized by the officers and such scrutiny will cause harassment to them.

Post-Vat Scene: Regarding post VAT scene, the Empowered Committee has announced that there will be fall in prices. The trading community is not ready to accept it, they feel that the States which buy raw materials from other states will have to pay CST as well as VAT and their finished goods will become

costly. The cost of compliance will also be passed on to the customers; hence there will be increase in prices of all the goods.

Uniformity in Taxation System: VAT is more scientific taxation system in comparison to the present system having double taxation at all the stages. One of the main objectives of introducing VAT system is to bring uniformity in rates of Sales Tax in all the states and to remove the cascading effect of the various state taxes and levies. The trading community is not willing to accept it as a sufficient ground to implement VAT.

VAT is functioning effectively in Central Excise as CENVAT (earlier MODVAT) since 1986; it is fully streamlined and stabilized. Ultimate aim of the Government is to merge all indirect tax, Central Excise duties, Service Tax, Sales Tax etc. into a single Goods and Services Tax (GST) administered at Centre and State level. Successful implementation of State level VAT is a must for that. There is a need to take everyone along with it. It appears that the fear in the mind of trading community is due to lack of proper information and lack of communication. At the same time, there is need to remove stringent provisions in VAT law and to provide natural justice to all to make it more transparent and user friendly. Once, the apprehensions of trading community are fully addressed, the sailing of VAT and consequently of GST will be smooth.

Preparedness of Corporate(s)

VAT is not just a replacement of existing sales tax regime. It is a change in Business strategies. It affects every walk of life in business models; say procurement policy, suppliers' chain, Distribution policy, Selling and Marketing strategies and finally the bottom line. Some of the tips given below may be of use to Corporate(s).

- In case the contract or agreement with customers is all inclusive type, then VAT liability could be demanded under "Change of Law" clause, being a new levy which was not in existence at the time of bagging the contract. States like Maharashtra is liberal to restrict the liability under the VAT regime to the extent of liability under old tax regime.
- Incase the contract or agreement with customers provides "taxes extra" then there should not be any problem in claiming the VAT liability, but at the same time some of the customer might have provided contractual clauses to pass on the cost benefits to them under the change of law regime.
- Since customers may insist more and more of local supplies, it is prudent to work out economics of adopting branch transfer or inter state sales where in the former 4% reversal of ITC is imminent and in the latter, CST absorption cannot be ruled out. One thing we need to keep it in our mind is, branch transfer route is legally permissible only for standard products and not for tailor made goods where the same will be conceived as" pre determined sales' by the department.
- *Procurement of capital goods*– Here also it is prudent to buy the capital goods outside the state at concessional rate of 4% rather than preferring staggered credit over the period of time.
- *Documentation and records keeping*— Considering the sweeping powers given to the department officials, this area calls for high order of discipline. Tax planning measures are properly documented and understood so that there is no room for the department to conceive that the agreement with customers is for evasion of taxes.
- *System configuration and IT support*– This is a complex area especially due to partial introduction of VAT. Some areas where changes are essential are as follows:

Technical Changes: Changes in the Purchase Order printing program, Changes in the commercial Invoice printing, Application of all necessary release notes and Program for analysis and updating of Open Purchasing Documents

Functional Changes: Configuration of New pricing conditions for VAT regime, Configuration of New accounting keys for VAT regime, Configuration Tax Calculation preparation, Configuration of Business Place and assignments to Plants, Configuration of Section codes and migration, Configuration in the Screen Layout of Vendor Master, Configuration in "Switching off " the Jurisdiction code, Configuration of Alternative G/L account Determination, Creation of New Sales Tax Codes and Updating of New and Old Tax codes.

The main objective of a uniform VAT is to integrate all taxes and also to do away with multiplicity of taxes. The success of the tax reform lies in how quickly we embark on this and integrate all taxes. But it is easier said than done.

Steps Needed to Stabilise VAT

1. **The Empowered Committee:** should continue to have periodical meetings with State Finance ministers/commissioners of Sales Tax on all transition issues and smooth working of VAT; Continue to persuade Non-VAT states to get on board at the earliest to create a common market and avoid diversion of trade; Continue the publicity campaign on VAT and draw a clear Road map for abolishment of CST (likely to be in 2007); take concrete steps to move towards an integrated GST regime.

2. **State Finance ministers:** They should not indulge in rate war and standby to the consensus arrived thro' White Paper; Should not levy any additional taxes which are not VATable; Check the benefits of VAT be passed on to final consumers; Introduce MRP based first point sales tax system under VAT for FMCG, goods and Rationalise the penal provisions and powers of the department officials so that VAT compliance is made voluntary and not under

3. **Commissioners of State VAT:** They should grant legitimate refund of Input Taxes without delaying but within the time schedule; Should not to invoke some mischievous enabling provisions casually just to harass the dealers; Should work towards a win–win situation so that the relationship between the dealer and the department through self assessment is built on "Trust" rather than monetary considerations.

4. **Dealers:** VAT is after all a give and take scenario where the dealers have to play their role more positively and diligently. They should be transparent and should not encourage bribing and should keep the records clean and avail the credit what is really due to them. They should represent the issues and seek advance ruling wherever possible so that litigations in courts are minimised. They should welcome VAT, which is here to stay. We have come a long way since independence in tax reforms. No tax reform was popular to begin with. But time, perseverance and co-ordination for economic stability in the states can make the new tax regime on par with 130 successful countries.

5. **Guidance Note on Accounting for State-level VAT:** Institute of Chartered Accountants of India 's guidance note on Accounting for State level VAT is very apt and timely. Since the guidance note is based on the White Paper, dealers have to fine-tune the accounting entries according to provisions of each state VAT law/rules. ■