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VALUE ADDED TAX [VAT]

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ICAI & ICSI Faculty

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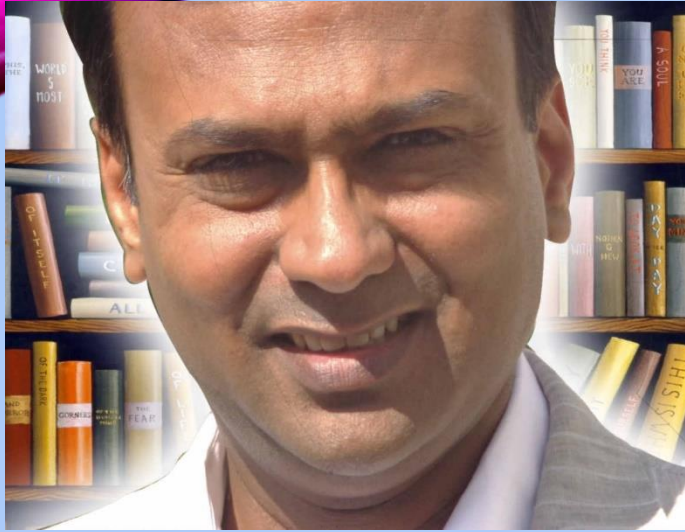
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|----|------------------------------|--------------|
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Indirect Tax

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1 General Principles

Tax on Expenditures



How many systems of sales tax are there ?

| | | | |
|----|--|-------------------------------|---|
| 1. | Single point taxation system. | | |
| | a. | First point sales tax system. | Tax levied at that time when first sale is made. This tax is generally collected from manufacturer. |
| | b. | Last point sales tax system. | Tax levied at that time when last sale is made. This tax is generally collected from retailer. |
| 2. | Multiple point taxation system. | | |
| | Tax is levied every time sale is made. | | |

| | First point sales tax | Last point sales tax | Multiple point sales tax | | | | | | | | | | | | | | |
|-------------------------------|--|--|--|-------|-----|-------|-----------|-------|-----|---------------------|----|-------|-----|---------|-----------|-------|-----|
| Revenue to Govt. | Very Low since tax is levied on low price. | High since sale shall be made by retailer to the ultimate consumer. | Very High since sale is made by large dealer to small dealer. | | | | | | | | | | | | | | |
| Tax Base | Invoice Price = Low | Invoice Price = High | Invoice Price = High | | | | | | | | | | | | | | |
| Cascading effect (tax on tax) | No since tax is levied only once at the time of first sale. | No since tax is levied only once at the time of last sale. Last sale is that sale which is made to that person who consumes the goods. | <div>Yes<table><tr><td>Value</td><td>100</td></tr><tr><td>+ Tax</td><td><u>10</u></td></tr><tr><td>Value</td><td>110</td></tr><tr><td>+ Expenses + Profit</td><td>90</td></tr><tr><td>Value</td><td>200</td></tr><tr><td>+ Tax *</td><td><u>20</u></td></tr><tr><td>Value</td><td>220</td></tr></table><p>* There is cascading of tax. Since tax is again levied on 200 which includes tax of ₹ 10 also.</p></div> | Value | 100 | + Tax | <u>10</u> | Value | 110 | + Expenses + Profit | 90 | Value | 200 | + Tax * | <u>20</u> | Value | 220 |
| Value | 100 | | | | | | | | | | | | | | | | |
| + Tax | <u>10</u> | | | | | | | | | | | | | | | | |
| Value | 110 | | | | | | | | | | | | | | | | |
| + Expenses + Profit | 90 | | | | | | | | | | | | | | | | |
| Value | 200 | | | | | | | | | | | | | | | | |
| + Tax * | <u>20</u> | | | | | | | | | | | | | | | | |
| Value | 220 | | | | | | | | | | | | | | | | |
| Administration | Very easy since tax is to be collected only from manufacturer. | Difficult since tax is to be collected only from retailers. | Very Difficult since tax is to be collected from very small to very large dealers. | | | | | | | | | | | | | | |

Note : Last point taxation system is the best system of taxation since IDT should be levied only when goods are ultimately consumed. But this system is very difficult to implement in India since there are many small dealers selling goods in every part of India including remote places.

What is the meaning of VAT?

| | |
|----|---|
| 1. | VAT is a mixture of multiple point taxation system and last point taxation system with system of set off of tax on earlier purchases. |
| 2. | VAT is a consumption tax because it is borne ultimately by the final Consumer. The tax paid by the dealer is passed on to the buyer. This consumption tax is also called destination based tax. |
| 3. | VAT is not charged on the dealer but is charged on to the ultimate consumer who bears the entire tax burden. Therefore nature of VAT is indirect tax since burden is passed on to the ultimate consumer. |
| 4. | Every dealer pays and collects VAT. A VAT would be paid by producers of raw materials all the way through to the retailer at the end of the chain of production and distribution till retailers. |
| 5. | Govt. collect the tax as soon as sale is made. |
| 6. | VAT is anti cascading. The tax paid on inputs is allowed to be set off from tax on sale. Therefore input tax is not treated as part of cost. If tax paid on input is not treated as part of cost then it shall not create cascading effect. |



| | |
|--|--|
| VAT has different meaning for different persons in a trade chain. Let us see it. | |
| From the point view of Govt. | VAT is a tax on value addition since Govt. collects tax on value addition. |
| From the point view of Dealer. | VAT is a tax on sale price. However a dealer pays tax to the Govt. on value addition. Tax payable = Output tax – Input tax credit. |
| From the point view of Consumer | VAT is tax on sale price. |

What are the advantages of VAT?

| | |
|-----|---|
| 1. | It is anti cascading. |
| 2. | Minimum possibility of tax evasion. |
| 3. | VAT prescribes simple computation of tax based on invoice price. |
| 4. | Fast collection of tax : Govt. collects tax at each stage of sale in small amount. This helps in better and fast collection of revenue even where goods have not been sold to ultimate consumer. |
| 5. | VAT is transparent system : Each purchasing dealer and consumer knows how much tax he is paying from the invoice price. Govt. knows how much tax is to be collected in each period. Therefore system of VAT is transparent. |
| 6. | In earlier first point taxation system various statutory forms need to be tracked. In VAT system only invoice is required to be tracked. All statutory forms have been abolished. |
| 7. | Dealer is required to himself compute the tax. This is called self assessment of tax. |
| 8. | VAT is both flexible and stable. Govt. collects revenue with the increase in sale price and shall collect less revenue with decrease in sale price. VAT is both flexible and stable. This benefit of increase or decrease in sale price benefits the consumer also. The total tax revenue of the Govt. depends entirely on the final value of ultimate goods and the rate of tax applicable to them. |
| 9. | The rate of tax of intermediary goods do not effect the tax collection of the Govt. |
| 10. | Change in intermediary rate of tax in the trade chain does not effect the ultimate consumer. |

Why VAT is easy to implement and how VAT helps in prevention of tax evasion? MAJOR ADVANTAGE

| | |
|----|---|
| 1. | VAT is a multiple point taxation system with a system of set off tax and therefore it leaves a chain of event. The chain of event is collection of tax and deposited with the Govt. |
| 2. | If manufacturer collects and deposits the tax with the Govt, so the distributor, wholeseller and retailer shall also collect and deposit the tax with the Govt. since they have been promised of adjustment. |
| 3. | However if manufacturer do not collect and deposit the tax with the Govt then subsequent dealer shall sale the goods without invoice thus evading tax. |
| 4. | In the VAT system Govt. need to check frequently the manufacturer that he issues correct invoice, collects tax and deposit with the Govt. Occasionally other dealers should also be checked. |
| 5. | Above measure expectantly can reduce the tax evasion. |
| 6. | Each selling dealer shall issue invoice then only set off shall be allowed. VAT system leaves a chain of ITC. This automatically prevents tax evasion. It is an automatic system to operate. Therefore less compliance burden on to the Govt. |

What are the disadvantages of VAT?

| | |
|----|--|
| 1. | VAT increases the sale price for ultimate consumer. So is every indirect tax. IDT is paid by both rich and poor. Burden on poor is heavy therefore VAT is anti poor tax. Its burden can be minimised by fixing the rate of tax on essential goods to the minimum. |
| 2. | VAT is inflationary and so is every indirect tax. Therefore this inflation can be minimised by fixing reasonable rate of tax. |
| 3. | VAT is paid by dealer and ultimately by the consumer. When dealer pays indirect tax his investment increases in stock in trade increases. He needs more working capital to run his business. This increase in investment leads to higher interest burden. Higher interest burden leads to burden on profit which shall lead to increase in sale price. Increase in sale price leads to higher tax. And higher tax higher sale price to consumer. |



| DIFFERENCE BETWEEN VAT SYSTEM & LAST POINT TAXATION SYSTEM | | |
|--|--|---|
| | VAT SYSTEM | LAST POINT / RETAIL TAX SYSTEM |
| From the point view of consumer | Consumer pays entire tax at the time of purchase. | In this case also consumer pays entire tax at the time of purchase. |
| From the point view of Govt. | Govt. collects tax in small amount at every time sale is made. Tax is collected on the value addition made. Govt. collects tax from every dealer in a trade chain. | Govt. collects entire tax in large amount from the retailer. |
| Administration | Easy to administer since purchasing dealer is promised set off by the Govt. | Difficult to administer since large numbers of small and large dealers. |
| Tax is reflected in which document. | Rate of tax and tax amount should separately be shown in dealer's invoice. | Rate of tax and tax amount should separately be shown in retailers invoice. |

PRACTICAL QUESTIONS

P1 : Compute VAT payable from the following information?

| | | |
|-------------------------------------|----------|--------|
| Purchases during the month @12.5% | 1,00,000 | 12,500 |
| Local sales during the month @12.5% | 1,20,000 | 15,000 |

Solution

| Details of purchases | | Base Sale Price | VAT / CST | | Sale Price |
|----------------------|----------------|-----------------|-----------|--------|------------|
| 1. | Local purchase | 1,00,000 | @ 12.5% | 12,500 | 1,12,500 |

| Details of Sales made | | Base Sale Price | VAT / CST | | Sale Price |
|-----------------------|------------|-----------------|-----------|--------|------------|
| 1. | Local sale | 1,20,000 | @ 12.5% | 15,000 | 1,35,000 |

| Output tax | Input tax credit | Tax Payable |
|------------|------------------|-------------|
| 15,000 | 12,500 | 2,500 |

P2 : Mr. X, a manufacturer sells goods to Mr. B, a distributor for ₹ 2,000 (excluding of VAT). Mr. B sells goods to Mr. K a wholesale dealer for ₹ 2,400. The wholesale dealer sells the goods to a retailer for ₹ 1,000, who ultimately sells to the consumers for ₹ 4,000. Compute the tax liability, input credit availed and tax payable by the manufacturer, distributor, wholesale dealer and retailer under the invoice method assuming VAT rate @ 12.5%.
(Nov 2009, 8 Marks)

Ans:

| Manufacturer | | | Distributor | | |
|----------------------|-----------|-------------|----------------------|----------------------|-------------|
| Output tax | Input tax | Tax payable | Output tax | Input tax | Tax payable |
| 12.5% of 2,000 = 250 | nil | 250 | 12.5% of 2,400 = 300 | 12.5% of 2,000 = 250 | 50 |

| Wholesaler | | | Retailer | | |
|----------------------|----------------------|-----------------------------------|----------------------|----------------------|-------------|
| Output tax | Input tax | Tax payable | Output tax | Input tax | Tax payable |
| 12.5% of 1,000 = 125 | 12.5% of 2,400 = 300 | (175)* * adjust in next month. | 12.5% of 4,000 = 500 | 12.5% of 1,000 = 125 | 375 |

Note : Cost to the ultimate consumer ₹ 4,500. Total tax collected by the Govt is 250 + 50 + (175) + 375 = 500 which is 12.5% of 4,000 = 500. The entire burden of ₹ 500 has fallen onto the consumer.



P3 : Compute the invoice value to be charged and amount of tax payable under VAT by a dealer who had purchased goods for ₹ 1,20,000 and after adding for expenses of ₹ 10,000 and of profit ₹15,000 had sold out the same. The rate VAT on purchase and sales is 12.5%. (Nov 2007, 3 Marks)

Ans :

Computation of invoice price

| | |
|-------------------|----------|
| Purchase price | 1,20,000 |
| Expenses | 10,000 |
| Profit | 15,000 |
| Total | 1,45,000 |
| Add : VAT @ 12.5% | 18,125 |
| Invoice price | 1,63,125 |

| Output tax | Input tax | Tax payable |
|----------------------------|----------------------------|-------------|
| 12.5% of 1,45,000 = 18,125 | 12.5% of 1,20,000 = 15,000 | 3,125 |

P4 : Compute the VAT amount payable by Mr. A who purchases goods from a manufacturer on payment of ₹ 2,25,000 (including VAT) and earn 10% profit on sale to retailer ? VAT rate on purchase and sale is 12.5%. (May 2009, 3 Marks)

Ans :

| Output tax | Input tax | Tax payable |
|----------------------------|--|-------------|
| 12.5% of 2,20,000 = 27,500 | $x + 12.5\% \text{ of } x = 2,25,000 = 25,000$ | 2,500 |

PAST EXAMINATION QUESTIONS

| | | |
|-----------|---|------------------------------|
| P1 | Briefly explain how VAT helps in checking tax evasion and in achieving neutrality. | May 2008 |
| P2 | Does the VAT system bring certainty to a great extent ? | Nov 2007 |
| P3 | Discuss the word “Transparency” in the context of VAT system. | May 2009 |
| P4 | Can VAT be said to be non-beneficial as compared to single stage-last point system? | Nov 2007 |
| P5 | Is it correct to state that VAT usually increases the retail price, as the tax is payable on the first sale price ? | May 2007 Nov 2008 |

DISADVANTAGE OF FIRST POINT SALES TAX

- 1 Since sales tax has to be collected at the first stage itself the tax rate has to be more. This encourages evasion. Now it becomes tax on honesty.
2. If goods escape first stage, the goods escape tax net altogether.
3. There is ample scope of under valuation at first stage itself.

DISADVANTAGE OF CASCADING EFFECT OF TAXES

1. Computation of exact tax content difficult. This becomes where export incentive is to be granted.
2. Discourages ancillarisation.
3. Increases cost of production.
4. Exports cannot be made tax free.



2 Methods of Computation of VAT

Experiments with tax



Meaning of few words

| | |
|--|--|
| What is value? | It is price paid for the goods. |
| What is value addition. [Addition method] | Manufacturing expenses (wages, salaries, electricity charges, shop rent, overhead charges) + trade expenses + Profits. |
| Value Added Tax. | It is tax on value addition. |
| Determination of sale price. | Purchase price + value addition. |
| Computation of value addition [Subtraction method]. | Sale price – Purchase price. Rates of tax (sale price – purchase price) |
| Formula for computation of tax. [Tax computation]. | Rates of tax x sale price – rates of tax x purchase price. |
| Input Tax Credit (ITC). | Tax on inputs. |

METHODS OF COMPUTATION OF VAT

There are 3 methods of computation of VAT.

| 1. Addition method | 2. Subtraction method | | 3. Input tax credit method |
|--------------------|--|--|----------------------------|
| | Direct Subtraction method also known as simple method [exclusive of tax] | Intermediate subtraction method also known as Sophisticated method [Inclusive of tax] | |

ADDITION METHOD

| | | | | | | | | | | | | | | | |
|--|---|--------|----------|-----------|----------|----------|----------|---------------------|--------|----------|--------|-----------------------|-----------------|------------------|---------------|
| In this method VAT is levied on expenses and profit. It is not levied on purchase price of inputs Value addition = All expenses + Profits Tax = Rates of tax x Value addition. | Example <table> <tr> <td>Profit</td><td>1,00,000</td></tr> <tr> <td>Shop Rent</td><td>2,00,000</td></tr> <tr> <td>Salaries</td><td>3,00,000</td></tr> <tr> <td>Electricity charges</td><td>50,000</td></tr> <tr> <td>Interest</td><td>50,000</td></tr> <tr> <td>Value addition</td><td>7,00,000</td></tr> <tr> <td>Tax @ 10%</td><td>70,000</td></tr> </table> | Profit | 1,00,000 | Shop Rent | 2,00,000 | Salaries | 3,00,000 | Electricity charges | 50,000 | Interest | 50,000 | Value addition | 7,00,000 | Tax @ 10% | 70,000 |
| Profit | 1,00,000 | | | | | | | | | | | | | | |
| Shop Rent | 2,00,000 | | | | | | | | | | | | | | |
| Salaries | 3,00,000 | | | | | | | | | | | | | | |
| Electricity charges | 50,000 | | | | | | | | | | | | | | |
| Interest | 50,000 | | | | | | | | | | | | | | |
| Value addition | 7,00,000 | | | | | | | | | | | | | | |
| Tax @ 10% | 70,000 | | | | | | | | | | | | | | |

Disadvantage of Addition method : Impractical to implement

| | |
|----|--|
| a. | This method of computation of VAT is possible only after the end of the year when final accounting statements have been prepared. |
| b. | VAT is an indirect tax. An indirect tax is one where the burden can be shifted to another person. And in this method burden cannot be shifted. |
| c. | A seller has to necessarily collect VAT from his buyers. It would be highly impossible for a seller to calculate the component of the total value addition that can be attributed to each commodity sold by him, that too, when final figures of total value addition are not available. |
| d. | It does not facilitate matching of invoices for detecting evasion. |
| e. | In case of multiple rates this method cannot be implemented. |

| | | |
|-----------|--|-----------------|
| P1 | What are the items aggregated in the Addition method to calculate VAT payable ? When is this method mainly used ? | May 2010 |
|-----------|--|-----------------|

**SUBTRACTION METHOD**

| | | | |
|---|---|--|-------|
| 1. | In this method tax is levied on value addition. | Sales bill under subtraction method | |
| 2. | Value addition = Sale – Purchase. | Base Sale price | 1,200 |
| 3. | Tax = Rates of tax x (Sale – Purchase) | + VAT @ 10% of 400 | 40 |
| In this method expenses + profit need not be known at the time of sale. Also expenses + profit need not be apportioned to each product. | | Sale Price | 1,240 |

E.g : Suppose a dealer buys a commodity for ₹ 800 and resells it for ₹ 1,200. The VAT rate 10%.

Value addition = 1,200 – 800 = 400.

VAT = 10% of 400 = 40.

Profit can be computed by back calculation, therefore a sale bill method should be prepared as shown below.

Sale price (inclusive of tax) ₹ 1,240.

| Disadvantage of Subtraction method : Impractical to implement | |
|--|---|
| a. | Purchase price of each product is needed for the purpose of computation of value addition. |
| b. | At the time of effecting sale of any commodity a dealer should know precisely its purchase price of each commodity. Where the dealer buys and sells hundreds of commodity it is difficult to identify purchase price of each commodity. |
| c. | This problem is more compounded for a manufacturer who does not sell the purchased goods as such but manufactures a new product out of them. |
| d. | In case of multiple rates this method cannot be implemented. |
| e. | Profit percentage is automatically disclosed in the invoice. |

| | | |
|-----------|--|-----------------|
| P1 | Discuss the 'Subtraction method' for computation of VAT. | May 2009 |
|-----------|--|-----------------|

ITC / INVOICE METHOD

- Value addition = Sale – Purchase.
- Tax = Rates of tax x (Sale – Purchase)
- By solving we get

$$\text{VAT} = \text{Rates of tax} \times \text{Sale} - \text{Rates of tax} \times \text{Purchase}$$

$$\text{VAT} = \text{Tax payable on sale (Output tax)} - \text{Tax payable on purchase (ITC)}$$

Therefore in this method tax is to be collected on value and not on value addition.

Under this method, tax is imposed at each and every stage of sales on the entire sale value, that is why it is called as multistage tax and the tax paid at earlier stage is allowed as set - off. This credit availability is called as input tax credit.

Invoice method is the most common and popular method for computing the tax liability under VAT system.

This method is also called 'Input tax credit method' or 'Voucher method'.

| Advantage of ITC method | |
|--------------------------------|---|
| a. | Purchase price of each product need not be known at the time of making sale. |
| b. | No one to one correspondence between purchase and sale. |
| c. | It is enough if total of taxes paid on purchases during a month and the total of taxes paid on sales during the same month are known. |
| d. | Profit percentage need not be disclosed by the dealer in the invoice. |
| e. | Input tax credit is available immediately at the time of purchase even if subsequent sale is not made. Also even if selling dealer has not deposited the tax. Also even if purchasing dealer has purchased the goods on credit, ITC is available. |
| f. | Even if goods are sold at a loss full ITC is available. |



| | |
|----|---|
| g. | If ITC is available on purchases then tax is not part of cost. Therefore it is tax neutral. It does not interfere in the choice of purchase as far as tax is concerned. Any amount of tax paid on purchases is eligible for input tax credit. If there are two raw materials for production of single finished goods and one raw material is subject to low rate and the other at high rate. Naturally the manufacturer will go for low rate but it will not make any difference since ITC is available. Hence he has to consider the other merits excluding the rate of tax while selecting the raw material. This is the Magic of VAT. It creates NEUTRALITY. |
|----|---|

PAST EXAMINATION QUESTIONS

| | | |
|----|---|----------|
| P1 | Explain "Input Tax Credit" in context of VAT. | Nov 2008 |
| P2 | Which is the most popular and common method for computing VAT liability and at what stage is the tax imposed? | May 2007 |
| P3 | Briefly explain the invoice method of computing tax liability under the VAT system. What are its other names? | Nov 2007 |
| P4 | Briefly explain how VAT achieve neutrality. | May 2008 |

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3

Tax Rates and Exemption

Tax the foods and luxuries



There are just four rates under VAT- the zero rate (exempted goods), 1%, 4% and a general rate of 12.5%. These rates will be uniform in all States across the country. The same set of goods will be charged at the same rates in all the States. Most essential commodities are exempt from VAT or fall in the category of 4%.

| | | |
|---|--|---|
| Exempted category. (General) (Non vatable) | a. | Natural & unprocessed products in unorganised sector. |
| | b. | Items which are legally barred from taxation |
| | c. | Items which have social implications. |
| Exempted category. (Special) | A set of maximum of 10 commodities flexibly chosen by respective States from a list of goods. | |
| 4% category | Largest number of commodities. It comprises of items of basic necessities like medicines, drugs, agricultural & industrial inputs, capital goods and declared goods. | |
| 12.5% category | Remaining commodities common for all States. | |
| 1% category | Precious stones, bullion, gold & silver ornaments. | |
| 20% flat. (Non VAT category) | Petrol, diesel, Air Turbine fuel, other motor spirits, liquor & lottery tickets. | |

VAT IS ANTI POOR TAX

VAT is consumption tax and since the ratio of expenditure to income is more in the case of poor as far as consumption is concerned than the rich hence to that extend it can be termed that VAT is any poor taxation system. This drawback of VAT can be neutralized by taxing the necessities at lower rate and luxuries at higher rate.

Causes Inflation

It is also argued that VAT causes inflation. It's impact will depend on various factors such as inventory holding period, demand supply position of that particular product, number of intermediaries etc. Investment in stock is bound to increase as tax will be paid at the time of purchase, hence one will have to carry tax paid stock.

Increase in Investment

Dealer will be making purchases after paying tax, therefore investment in stock will go up the extent of tax paid. Under old system the dealer was making purchases against statutory forms, hence was not liable to pay tax on it's purchases.

PAST EXAMINATION QUESTIONS

| | | |
|-----------|--|-----------------|
| P1 | What are the tax rates under VAT ? | Nov 2009 |
| P2 | What is the demerit of VAT from the view point that it is form of consumption tax / anti poor tax? | May 2008 |

4

Variants of VAT

Tax increases the cost of investment



IS ITC AVAILABLE ON CAPITAL GOODS?

- Capital goods include Plant and machinery, furniture, fixture, electrical installations, vehicles, building materials etc. All these items are subjected to VAT.
- Normally, under VAT system the dealer should get full credit for tax paid on capital goods as the basic principle of VAT is to avoid cascading effect of tax.
- Since these assets are used for the purpose of business and if tax paid on these purchases are not allowed to be set off, then tax paid on these inputs are treated as cost to the purchaser. While marking up the price on account of establishment cost he has to consider the cost of furniture as one of the components. If cost remains higher, obviously to that extent the mark up price will go up. If the cost is lower i.e. after considering input cost the cost will be lower and to that extent the mark up will also be lower.
- When tax paid on purchases is included in cost, the said cost indirectly gets reflected in the sale price and hence there is also an element of tax on tax. Depending upon the volume of capital goods and the tax component on the same the magnitude of the cascading effect can be imagined.
- Whether ITC should be available on capital goods it shall depend upon the following variants of VAT.

VARIANTS OF VAT AND ITS DIFFERENCE

| Gross Product Variant | Income Variant | Consumption Variant |
|--|---|--|
| ITC not available on capital goods. | ITC available on capital goods in the ratio of depreciation over the life of the capital asset. | Full ITC is available on capital goods at the time of purchase. Few State Govt. has allowed ITC either in 24 / 36 installments. |
| If ITC is not available then it is treated as part of cost on which depreciation can be claimed. | ITC is available therefore not treated as part of cost. Depreciation is not available on ITC. | ITC is available therefore not treated as part of cost. Depreciation is not available on tax paid on purchases. |
| It creates double taxation first capital goods are taxed and then at the time of sale of goods produced using those capital goods again it is taxed. Modernization and upgrading of plant and machinery might be delayed due to this double tax treatment and high investment. | Here there is no double levy. There are difficulties connected with the specification of any method of measuring depreciation, which basically depends on the life of an asset as well as on the rate of inflation. This method provides incentives to classify purchase as current expenditure to claim set off. | Here also there is no double levy. It does not affect decisions regarding investment because the tax on capital goods is also set off against the VAT liability. Hence, the system is tax neutral in respect of techniques of production (labour or capital intensive). Convenient from the point of administrative expediency as it simplifies tax administration by obviating the need to distinguish between purchases of intermediate and capital goods on the one hand and consumption goods on the other hand. The consumption variant is more in harmony with the destination principle. |
| It causes inflation. | It causes partial inflation. | It do not causes inflation. |



| | Gross Product Variant | Consumption Variant |
|----|---|---|
| 1. | ITC not available on capital goods. | ITC available on capital goods. |
| 2. | If ITC is not available then VAT is a part of cost. | ITC is not a part of cost since credit is available |
| 3. | Depreciation is available on cost including VAT. | Depreciation cannot be claimed on VAT. Since not a part of cost. If claimed it amounts to double benefit. |
| 4. | Cost of VAT is indirectly reflected in price of final product which is again subjected to VAT. It is indirect cascading of tax. | There is no cascading of tax since ITC is available on VAT. |
| 5. | Increase in cost shall delay modernisation of plant. | VAT shall not effect this decision. |

PAST EXAMINATION QUESTIONS

| | | |
|-----------|---|------------------------------|
| P1 | What are the different variants of VAT, and how is deduction available for tax paid on inputs including capital inputs? | Nov 2007 |
| P2 | Briefly explain the income variant of VAT. | May 2008 Nov 2009 |
| P3 | Fill the blanks for the following items in the context of VAT: | Nov 2013 |
| (i) | The most commonly used method for computing VAT is the _____ method. | |
| (ii) | The most widely used variant amongst the various ones is the _____ variant. | |
| (iii) | When a dealer opts for Composition Scheme, the VAT chain _____ (continues/gets broken). | |
| (iv) | _____ amongst the following is not an applicable VAT rate : 0,1,8 and 12.5 | |

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5

Availability of ITC

So many taxes



ITC is available only when goods are locally purchased.

IS ITC AVAILABLE ON CST?

No, ITC is not available on CST since CST is paid to that State from where movement of goods first commences.

| | VAT | CST |
|--------------------------|--|--|
| LEVY | VAT is a sales tax levied when local sale is made. | CST is also sales tax but levied when inter state sale is made. |
| PRINCIPLE | VAT follows consumption principle of taxation. It means tax is collected by that Govt. where goods are consumed. | CST follows origin principle of taxation. It means tax is collected by that Govt. from where movement of goods first starts. |
| WHICH GOVT. COLLECTS TAX | That State Govt. where goods are consumed. | That State Govt. from where movement of goods first starts. |

STATUS OF ITC IN CASE OF INTER STATE CONSIGNMENT

In case of inter state consignment CST could not be collected by selling State. Selling State has lost so much of CST. Therefore selling State shall reverse the ITC by the amount of that CST which should have been collected by the selling State.

| | | |
|-----------|--|-----------------|
| P1 | Discuss the tax consequences of Stock Transfer under the VAT scheme? | May 2010 |
|-----------|--|-----------------|

IS ITC AVAILABLE ON IMPORTED GOODS?

No, since tax is paid to CENTRAL Govt. VAT is State legislation. Also CG do not allow CENVAT on BCD. {Central Value added tax} {Basic Custom Duty}

IS VAT PAYABLE WHEN GOODS ARE EXPORTED OUTSIDE INDIA?

No, since VAT is destination based / consumption based taxation and goods are consumed outside country. But such goods has suffered VAT before the goods were exported outside India, therefore Govt shall refund the tax which was levied before the goods were exported outside India. This is also called ZERO RATING.

| ZERO RATING | A SALE BEING EXEMPTED FROM TAX |
|---|---|
| EXEMPTING not only sale on export but also REFUNDING the taxes paid for the purchase made for that sale. | Tax is not levied at any stage. It is different from zero rating where tax is first collected and then refunded. |
| AS PER WHITE PAPER ON VAT - For all exports made out of the country, tax paid within the State shall be refunded in full, and this refund will be made in 3 months. | Exempt goods are those goods whose tax rate is zero, but input tax credit will not be available. Essential items such as agricultural implements manually operated or animal driven, books, periodicals, journals, fresh milk, etc. are in the exempted category. |

WHAT IS THE TAX TREATMENT OF UNITS LOCATED IN SEZ AND EOU?

SEZ, STP etc. are being set up to promote industry and create industrial base. Sales to a unit under Special Economic Zone (SEZ), Software Technology Park (STP), Electronic Hardware Technology Park (EHTP), etc. are treated on par with export and treated as deemed export. Hence, the goods sold to SEZ, STP are zero rated to encourage export. As per White paper on VAT Units located in SEZ and EOU will be granted either exemption from payment of input tax or refund of the input tax within 3 months.

In these transactions the tax rate will be zero and input tax credit will be available. The purpose is that the goods exported or sold to outside the State will be free of any load of tax in it, which will increase competitiveness and encourage exports.

6 Dealer

Dealers are the agents of the Govt.



| | Very Small dealer | Small dealer | | Large dealer |
|---------------------|--|--|---|---|
| Turnover | upto ₹ 10 Lakhs | exceed 10 Lakhs & upto ₹ 50 lakhs | | exceeds ₹ 50 lakhs |
| | | opts for composition scheme | | |
| | | Yes | No | |
| Input tax | Input tax has to be paid but credit is not available | Input tax has to be paid but credit is not available | Input tax has to be paid also credit is available | Input tax has to be paid also credit is available |
| Output tax | No authority to collect output tax | No authority to collect output tax | Has the authority to collect output tax | Has the authority to collect output tax |
| Registration | Voluntary | Compulsory | Compulsory | Compulsory |
| Books of accounts | Not required to be maintained | Yes but not in detail | Yes in detail | Yes in detail |
| Tax payment | Nil | 1% of sales turnover | Output tax – ITC | Output tax – ITC |
| Applicability | Only for traders making local sale | Only for traders making local sale | All traders, manufacturers, importers, dealer making inter state sale | All traders, manufacturers, importers, dealer making inter state sale |
| Govt. loses revenue | Yes | No | No | No |

ADVANTAGE AND DISADVANTAGE OF COMPOSITION SCHEME

| Advantages | | Disadvantages | |
|------------|---|---------------|---|
| 1. | There is no necessity to maintain accounts for the taxes paid on purchases. The maintenance of accounts will be simple. | 1. | The dealer will not give input tax credit for his purchases. |
| 2. | There is no necessity to give details of purchases in the monthly returns. | 2. | The other dealers may not prefer to purchase from this dealer because they will not get input tax credit for those purchases. Cost to consumer is same whether it buys from composition dealer or large dealer. |
| | | 3. | He will not entitled to issue TAX INVOICE to the buyer. It can issue only Non-Vatable invoice. It shall lead to break in VAT chain. |

| Question | | Solution |
|----------|--|---|
| 1. | Is ITC available where goods are purchased from small dealer? | No |
| 2. | Is ITC available if goods are purchased from composition dealer? | No. This is even if that composition dealer is paying the VAT @ 1%. Composition dealer shall issue non-vatable invoice. The burden of tax cannot be passed. |
| 3. | Is ITC available where goods are purchased from large dealer? | Yes |

**WHICH DEALER CAN AVAIL COMPOSITION SCHEME**

1. A dealer who intends to avail such composition scheme shall exercise the option in writing for a year or a part of the year in which he gets himself registered. For this the dealer has to intimate to the Commissioner.
2. The dealer should not have any stock of goods which were brought from outside the State on the day he exercises his option to pay tax by way of composition and shall not use any goods brought from outside the State after such date.

Effects if dealer avails composition scheme.

1. He need not maintain any statutory records as prescribed under the Act. Only the records for purchase, sales, inventory should be maintained.
2. The dealer should also not claim input tax credit on the inventory available on the date on which he opts for composition scheme.
3. Dealer cannot issue VATABLE invoice. Cannot avail ITC on purchases therefore treated as part of cost. Cannot pass output tax of 1% of turnover to the selling dealer. This tax of 1% of turnover is treated as part of cost.

PRACTICAL QUESTION**P1 : Calculate VAT and CST from the following information:**

| | |
|--|----------|
| Inputs purchased within the State. | 1,70,000 |
| Capital goods used in the manufacture of the taxable goods. | 5,00,000 |
| Inputs purchased from the registered dealer who opts for composition scheme. | 10,000 |
| High Seas purchase of inputs. | 1,00,000 |
| Finished goods sold:- | |
| • Within the State. | 2,00,000 |
| • In the course of inter-State trade. | 2,50,000 |
| Tax Rates | |
| VAT on Inputs and capital goods | 4% |
| Output tax within the State | 12.5% |
| CST | 2% |

Solution

| Output tax | | Input tax credit | |
|--|--------------|--|---------------|
| VAT payable on local sales (12.5% of 2,00,000) | 25,000 | ITC on local purchase (4% of 1,70,000) | 6,800 |
| CST payable on Inter State Sale (2% of 2,50,000) | <u>5,000</u> | ITC on capital goods (4% of 5,00,000) | <u>20,000</u> |
| Output tax | 30,000 | ITC | 26,800 |
| Tax payable 30,000 - 26,800 = 3,200 | | | |

PAST EXAMINATION QUESTION

| | | |
|-----------|---|-----------------|
| P1 | Is any threshold exemption limit fixed for dealers to obtain VAT registration, as per the White paper ? If yes, why is the same provided. | May 2010 |
| P2 | Is the VAT chain continued when a purchasing dealer opts for VAT composition scheme ? What is the loss to the seller and the buyer opting for the composition scheme, and the subsequent buyers ? | |



7

Input Tax Credit

System of Taxation



ALL ABOUT ITC

GOLDEN RULE : ITC is available only on local purchases and can be adjusted with tax on sale. (Output tax)

| | |
|----|--|
| 1. | ITC not available if taxes paid to other State Govt. or to Central Govt. |
| a. | CST since tax is paid to other State Govt. |
| b. | Import duty (CENVAT not available). Excise duty and service tax (CENVAT is available). |
| 2. | In certain cases goods locally purchased but ITC not available. In certain cases ITC availed shall be reversed. |
| a. | Goods lost. ITC if availed shall be reversed. |
| b. | Output sale of goods is exempted. ITC is not available at the time of purchase. But if goods are subsequently exempted then ITC availed earlier shall be reversed. |
| c. | Goods purchased for personal purpose. ITC shall not be available. |
| d. | Purchase of NON VATABLE goods. E.g. Petrol. On purchase of petrol ITC is not available. |
| e. | Goods purchased from composite dealer. ITC is not available since it cannot issue VATABLE invoice. |
| f. | Purchases made from unregistered dealer ITC is not available since it cannot issue invoice. |
| g. | Purchase of goods where purchase invoice is not available with the claimant or there is evidence that the same has not been issued by the registered selling dealer from whom the goods are purported to have been purchased. (Fake invoice) |
| 3. | Where goods are used both for selling exempted and taxable finished goods proportionate ITC is available. |
| 4. | In following cases ITC availed immediately but subsequently reversed. |
| a. | Goods returned. |
| b. | Inter state transfer. |
| c. | Goods given for free. |
| 5. | In following cases ITC availed but subsequently refunded. |
| a. | Where goods are exported then entire VAT shall be refunded. |
| b. | Sale of goods to SEZ, ITC shall be refunded. |

IS ITC AVAILABLE ON PETROL, DIESEL, ATF, OTHER MOTOR SPIRITS, LIQUOR AND LOTTERY TICKETS?

No, more than 50% of revenue comes from this source. Moreover it is difficult to identify exactly whether these are used for industrial purpose or for personal purpose.

WHAT IF GOODS PURCHASED ARE USED BOTH FOR PRODUCTION OF EXEMPTED GOODS AND DUTIABLE GOODS?

ITC shall be allowed proportionately.

WILL ITC BE AVAILABLE ON PURCHASE OF SECOND HAND MACHINERY?

Yes. The requirement of law in respect of purchase of second hand machinery is the same as for new machinery. If the purchase of second hand machinery otherwise satisfies all other requirement of availability of input tax credit, the credit will be available.



WHAT AMOUNT WILL BE AVAILABLE AS ITC IN CASE MACHINERY IS USED BOTH FOR MANUFACTURE OF DUTIABLE GOODS AS WELL AS EXEMPTED GOODS ?

The input tax credit will be available on a proportionate basis.

VAT INCREASES THE ADMINISTRATIVE COST / DISADVANTAGE OF VAT

VAT is a complicated system hence it increase the accounting cost. This burden is more on small traders and firms. Further since the tax is paid at each stage hence it increases the working capital requirement.

Detailed Records

Like any other system VAT is also not free from all evils. Though on record it is said to be the simplest method, however, it is more complicated than a simple first point tax. Many small dealers maintain only primitive accounts and it is very difficult for them to keep proper and detailed records required for VAT purposes.

Functional Problems

The functional problem of VAT is that input tax credit is allowed on the basis of the original invoices issued by the dealer. In respect of invoices where tax is charged and collected by the buying dealer, the selling dealer, is entitled to take credit even if tax is not deposited by the selling dealer with the Govt. Provisions to protect the interest of the dealers who have paid the tax should be made.

Audit under VAT

Most of the states introduced VAT on 1-4-2005 and they have incorporated audit provisions in the Legislation itself. Audit under VAT is important for better and effective implementation of the VAT system.

Note : If VAT is not shown separately in the invoice ITC is not available.

PAST EXAMINATION QUESTION

| | | |
|-----------|--|-----------------|
| P1 | List out nine purchases which are not eligible for input tax credit. | Nov 2009 |
| P2 | What are the exceptions to input tax credit ? | Nov 2008 |
| P3 | State with reasons in brief whether the following statement is true or false with reference to the provision of Value Added Tax. The VAT Rate on sale of Lottery Ticket is 4%. | Nov 2009 |
| P4 | Can VAT be said to be non-beneficial as compared to single stage-last point system? | Nov 07 |
| P5 | VAT would increase the working capital requirements and the interest burden. Discuss. | Nov 09 |

PRACTICAL QUESTIONS

P1 : Mr. X a dealer in Mumbai dealing in consumer goods, submits the following information pertaining to the month of March 2011.

| | |
|----|---|
| a. | Exempt goods A purchased for ₹ 2,00,000 and sold for ₹ 2,50,000. |
| b. | Goods B purchased for ₹ 2,25,000 (including VAT) and sold at a margin of 10% profit on purchases (VAT rate 12.5%) |
| c. | Goods C purchased for ₹ 1,00,000 (excluding VAT) and sold for ₹ 1,50,000 (VAT rate 4%) |
| d. | His unutilised VAT balance in VAT input tax credit on 1-3-2011 was ₹ 1,500. |

Ans:

Goods A : Exempted goods therefore no VAT liability arises.

Goods B :

| | |
|----------------|----------|
| Invoice price | 2,25,000 |
| Less : VAT | (25,000) |
| Purchase price | 2,00,000 |



| | |
|---------------------------|----------|
| Add : Profit margin @ 10% | 20,000 |
| Total | 2,20,000 |
| Add : VAT @ 12.5% | 27,500 |
| Invoice price | 2,47,500 |

Goods C:

| | |
|----------------|----------|
| Purchase price | 1,00,000 |
| Add : VAT | 4,000 |
| Purchase price | 1,04,000 |
| Sale price | 1,50,000 |
| Add : VAT @ 4% | 6,000 |
| Invoice price | 1,56,000 |

| Output tax | | Input tax credit | |
|------------|--------|----------------------|--------------|
| Goods A | nil | Credit of March 2010 | 1,500 |
| Goods B | 27,500 | Goods A | nil |
| Goods C | 6,000 | Goods B | 25,000 |
| | | Goods C | 4,000 |
| Total | 33,500 | Total | 30,500 |
| | | Tax payable | 3,000 |

P2 : Mr. Rajesh is a registered dealer and gives the following information. You are required to compute the net tax liability and total sales under the VAT from the following information.

| | | |
|---|--|----------------------|
| 1 | Rajesh sells his products to dealers in his state and other states as well. | |
| 2 | The profit margin in 15% of cost of production and VAT rate of sales is 12.5% of sales. | |
| 3 | Intra state purchase of raw material is ₹ 2,50,000 (excluding VAT of 4%) | |
| 4 | Purchase of raw material from an unregistered dealer Rs, 80,000 (including VAT of 12.5%) | |
| 5 | Import of raw material ₹ 1,85,000 (excluding custom duty of 10%) | |
| 6 | Purchase of raw material from other state ₹ 50,000 (excluding CST of 2%) | |
| 7 | Transportation charges, wages and other manufacturing expenses excluding tax ₹ 1,45,000 | |
| 8 | Interest on bank loan ₹ 70,000. | IPCC Nov 2010 |

Ans:

Calculation of Total sale price ₹

| | |
|--|-------------------|
| (1) Cost of materials purchased from intra state excluding tax | 2,50,000 |
| (2) Cost of materials purchased from unregistered dealer including VAT | 80,000 |
| (3) Cost of materials purchased from overseas including custom duty | 2,03,500 |
| (4) Cost of materials purchased from interstate trade including CST | 51,000 |
| (5) Transportation charges, wages and other expenses | 1,45,000 |
| (6) Interest paid | 70,000 |
| Total cost of production | 7,99,500 |
| Add: profit margin 15% of cost | 1,19,925 |
| Total sale price | 9,19,425 |
| VAT @ 12.5% | 1,14,928 |
| Less: Input VAT credit (only for intra state sale transaction) 2,50,000 X 4% | 10,000 |
| VAT amount payable rounded off in multiples of | ₹ 1,04,928 |



P3 : Mr. Goenka, a trader selling raw materials to a manufacturer of finished products. He imports his stock in trade as well as purchases the same from the local markets. Following transaction took place during financial year 2008-09. Calculate the VAT and invoice value charged by him to a manufacturer. Assume the rate of VAT @ 12.5%

| | | |
|----|--|----------|
| a. | Cost of imported materials (from other State) excluding tax | 1,00,000 |
| b. | Cost of local materials including VAT | 2,25,000 |
| c. | Other expenditure includes storage, transport, interest and loading and unloading and profit earned by him | 87,500 |

(Nov 2009, 5 Marks)

Ans:

| | |
|--|----------|
| Cost of raw material imported from other state | 1,00,000 |
| + CST @ 2% | 2,000 |
| Cost of local raw material excluding VAT | 2,00,000 |
| Other expenditures incurred | 87,500 |
| Total | 3,89,500 |
| + VAT @ 12.5% | 48,688 |
| Invoice price | 4,38,188 |

P4 : The following particulars are provided by Mr. Purohit of Calcutta, who has purchased Raw materials for manufacturing PVC Cans and PVC Pipes from Mr. Arvind. The State VAT for Raw Materials and other materials was 12.5%.

| | | |
|----|---|----------|
| 1. | Cost of raw materials purchased. | 1,00,000 |
| 2. | VAT paid by Mr. Arvind | 12,500 |
| 3. | Cost of other materials | |
| | -- Local | 20,000 |
| | -- Inter state Purchases | 40,000 |
| 4. | VAT paid on Local Materials Purchased 12.5% | 2,500 |
| 5. | CST Paid @ 2% | 800 |
| 6. | Manufacturing Expenses | 39,200 |
| 7. | Profit Margin (on Sale Value) | 20% |

Mr. Purohit utilized and manufactured 75% of production as PVC Cans and 25% of production as PVC Pipes. While PVC Cans are subject to 12.5% VAT, PVC Pipes are exempt. All materials were used in production and there was no closing stock of raw materials and other materials.

What would be the invoice value of Sales charged by Mr. Prohit if all the manufactured goods were sold within the State? What would be his liability to VAT?

(PCC Nov 11, M 5)

Solution

| | | Purchase price | VAT / CST | Total |
|----|-----------------------------------|----------------|-----------|----------|
| 1. | Local purchase of RM | 1,00,000 | 12,500 | 1,12,500 |
| 2. | Local purchase of other materials | 20,000 | 2,500 | 22,500 |
| 3. | Inter state purchase | 40,000 | 800 | 40,800 |

Computation of Sale Price

| Particulars | PVC Can (75%) | PVC Pipes (25%) |
|--------------------------------------|--------------------------|--------------------------|
| 1. Local purchase of RM | 75% of 1,00,000 = 75,000 | 25% of 1,12,500 = 28,125 |
| 2. Local purchase of other materials | 75% of 20,000 = 15,000 | 25% of 22,500 = 5,625 |
| 3. Inter State purchase | 75% of 40,800 = 30,600 | 25% of 40,800 = 10,200 |
| Total material cost | 1,20,600 | 43,950 |
| Manufacturing expenses ₹ 39,200 | 75% of 39,200 = 29,400 | 25% of 39,200 = 9,800 |



| | | |
|--|----------|----------|
| Total cost | 1,50,000 | 53,750 |
| Profit | 37,500 | 13,438 |
| Base sale price | 1,87,500 | 67,188 |
| + VAT @ 12.5% | 23,438 | nil |
| Sale Price | 2,10,938 | 67,188 |
| <u>VAT payable</u> | | |
| Output tax | | 23,438 |
| Less : Input tax credit (75% of 12,500 + 75% of 2,500) | | (11,250) |
| VAT payable | | 12,188 |

P5 : The following are details of purchases, sales, etc. effected by Varadan & Co., a registered dealer, for the year ended. Compute the VAT liability of the dealer for the year ended.

| Particulars | Amount |
|---|-----------|
| Purchase of raw materials within State (500 units, inclusive of VAT levy at 12.5%) | 11,25,000 |
| Inter-State purchases of raw materials, inclusive of CST at 4% import of packing material, inclusive of customs duty of 10,000 | 4,08,000 |
| Imported raw material. VAT @ 5% inclusive | 2,10,000 |
| Capital goods purchased. VAT @ 10% inclusive (input credit to be spread over 2 financial years) | 5,50,000 |
| Sales of taxable goods within State, inclusive of VAT levy at 4%. | 40,24,000 |
| Sales of goods within State, exempt from levy of VAT (Goods were manufactured from the Inter- State purchase of raw materials). | 1,20,000 |

Solution

| Details of purchases | Base Sale Price | VAT / CST | Sale Price |
|--------------------------|-----------------|-----------|------------|
| 1. Local purchase | 10,00,000 | @ 12.5% | 11,25,000 |
| 2. Inter state purchase | 3,92,308 | @ 4% | 4,08,000 |
| 3. Imported raw material | 2,00,000 | @ 5% | 2,10,000 |
| 4. Capital Goods | 5,00,000 | @ 10% | 5,50,000 |

| Details of Sales made | Base Sale Price | VAT / CST | Sale Price |
|--------------------------|-----------------|-----------|------------|
| 1. Local sale | 38,69,231 | @ 4% | 40,24,000 |
| 2. Local sale (exempted) | 1,20,000 | nil | 1,20,000 |

| <u>VAT payable</u> | |
|--------------------------------|------------|
| Output tax | 1,54,769 |
| Less : ITC (1,25,000 + 25,000) | (1,50,000) |
| VAT payable | 4,769 |

P6 : Mr. Bansilal of Punjab is a manufacturer, registered under VAT. He provides the following particulars for the financial year 2012-13.

| | | |
|----|--|----------|
| 1. | Purchases from local registered dealer (excluding VAT 4%) | 1,15,000 |
| 2. | Purchases from a dealer having opted composition scheme (includes VAT 4%) | 2,20,000 |
| 3. | Purchases of machinery eligible for input credit on 1-10-12 (excluding VAT 4%) Depreciation rate 15% p.a. | 5,00,000 |
| 4. | Other direct & indirect expenses - 30% of total purchases (excluding depreciation) | |
| 5. | Profit margin - 20% of the cost. | |



| | | |
|----|--|-------|
| 6. | Unutilized balance of VAT input credit as on 1-4-2012. | 7,500 |
| 7. | 90% of the production is sold during the year. | |
| 8. | VAT rate for sales is 12.5% | |

Find the taxable turnover, net VAT payable and input credit for the year 2012-13.

Solution

| Purchase Bill | | | | | |
|----------------|----------|----------------|----------|------------------------|----------|
| Bill 1 (input) | | Bill 2 (input) | | Bill 3 (capital goods) | |
| BSP | 1,15,000 | Sale price | 2,20,000 | BSP | 5,00,000 |
| + VAT @ 4% | 4,600 | | | + VAT @ 4% | 20,000 |
| SP | 1,19,600 | | | SP | 5,20,000 |

| Computation of cost | |
|--|----------|
| Total cost of inputs (1,15,000 + 2,20,000) | 3,35,000 |
| + Direct and indirect cost (30% of 3,35,000) | 1,00,500 |
| Total Cost | 4,35,500 |

Note : Cost of machinery cannot be part of cost of product. Depreciation is a part of cost. But the question specifically mentions that while computing cost of production ignore the depreciation.

| Computation of Sale Price | |
|-----------------------------------|----------|
| BSP (90% of 4,35,500) | 3,91,950 |
| + Profit margin (20% of 3,91,950) | 78,390 |
| BSP | 4,70,340 |
| + VAT @ 12.5% | 58,793 |
| Sale Price | 5,29,133 |

Note : Full ITC is available and can be adjusted even if the goods are lying in stock.

| Computation of VAT | |
|---|----------|
| Output VAT | 58,793 |
| Less : ITC on inputs | (4,600) |
| Less : ITC on capital goods (assumed 100% ITC is available immediately at the time of purchase) | (20,000) |
| Less : Brought forward ITC | (7,500) |
| VAT payable | 26,693 |

P7 : S Ltd purchases following goods in the month of April.

| | |
|--|---|
| 1. | Goods A. MRP ₹ 30 per unit. Total units purchased 10,000. Trade discount 30%. Cash discount ₹ 10,000. VAT rate 12.5%. |
| 2. | Goods B. MRP ₹ 50 per unit. Total units purchased 15,000. Trade discount 40%. VAT rate 4%. |
| The following goods were sold in the month of April. | |
| 1. | Goods A. MRP ₹ 30 per unit. Total units sold 7,000. Trade discount 20%. VAT rate 12.5%. |
| 2. | Goods B. MRP ₹ 50 per unit. Total units sold 10,000. Trade discount 25%. VAT rate 6%. |
| Compute VAT payable for the month of April and carryforward in the month of May. | |

Ans : Input tax credit ₹ 43,000. Output VAT ₹ 43,500.



P8 : Compute net VAT liability of Sachin from the following information:

| | | |
|---|---------------|----------|
| Raw materials from foreign market (includes duty paid on imports @ 20%) | | 1,20,000 |
| Raw materials purchased from local market | | |
| Cost of raw material | 2,50,000 | |
| Add : Excise duty @ 12% | <u>30,000</u> | |
| | 2,80,000 | |
| Add : VAT @ 4% | <u>11,200</u> | 2,91,200 |
| Raw materials purchased from neighboring State (includes CST @ 2%) | | 51,000 |
| Storage and transportation cost | | 9,000 |
| Manufacturing expenses | | 30,000 |

Sachin sold goods to Madan and earned profit @ 12% on the cost of production. VAT rate on sale of such goods is 4%. There is no opening or closing stock. **IPCC N 2013**

Solution

| Computation of cost | |
|---|---------------|
| Raw material purchased from foreign market. CCR is not available on import duty therefore part of actual cost | 1,20,000 |
| Raw material purchased from local market. • CCR available on excise duty therefore not part of actual cost. • ITC available on VAT therefore do not form part of actual cost. | 2,50,000 |
| Inter state purchase of raw material. ITC not available on CST therefore part of actual cost. | <u>51,000</u> |
| Total cost of inputs | 4,21,000 |
| + Manufacturing expenses | 30,000 |
| + Storage and transportation cost | <u>9,000</u> |
| Cost of production | 4,60,000 |
| + Profit @ 12% of cost which is 12% of 4,60,000 | <u>55,200</u> |
| Base sale price | 5,15,200 |
| + VAT @ 4% | <u>20,608</u> |
| Sale Price | 5,35,808 |

| Computation of VAT | |
|----------------------|---------------|
| Output VAT | 20,608 |
| Less : ITC on inputs | <u>11,200</u> |
| VAT payable | 9,408 |

P9 : Mr. Vijay a registered dealer from Gujarat, submits the following the information pertaining to the month of January 2014.

- 1) Purchase of Raw material A for ₹ 3,50,000 which was exempt from levy of VAT and utilized for production of X.
- (2) Purchase of Raw material B for ₹ 7,60,000 on which VAT is paid @ 1% and utilized for the production of product Y.
- (3) Purchase of Raw material C for ₹ 10,00,000 on which VAT is paid @ 12.5% and utilized 50% each for production of product Z and product E.

Particulars of Sales are :

- (A) Sold X for ₹ 5,00,000 in Gujarat on which VAT is leviable at 4%.
- (B) Sold Y for ₹ 6,00,000 in Gujarat on which VAT is leviable at 0%.
- (C) Sold Z for ₹ 4,00,000 in Delhi @ CST 2%.



(D) Sold E for ₹ 12,00,000 which is exempt from levy of VAT.

Assuming there is no opening and closing inventory, calculate the amount of VAT payable for the relevant month. **IPCC M 2014**

Solution 1(C)

| Purchase Bill | | | | | |
|---------------------------------|----------|---|----------|--|-----------|
| Bill 1 (RM A) | | Bill 2 (RM B) | | Bill 3 (RM C) | |
| BSP | 3,50,000 | BSP | 7,60,000 | BSP | 10,00,000 |
| + VAT | Nil | + VAT @ 1% | 7,600 | + VAT @ 12.5% | 1,25,000 |
| SP | 3,50,000 | SP | 7,67,600 | SP | 11,25,000 |
| ITC is available but VAT is nil | | ITC is not available since RM B is used for production of Product Y which is subject to 0% VAT. | | Only 50% ITC is available since 50% RM C is used for production of dutiable product Z. | |

| Sale Bill | | | | | | | |
|--------------------|----------|--------------------|----------|--------------------|----------|--------------------|-----------|
| Bill 1 (Product X) | | Bill 2 (Product Y) | | Bill 3 (Product Z) | | Bill 3 (Product E) | |
| BSP | 5,00,000 | BSP | 6,00,000 | BSP | 4,00,000 | BSP | 12,00,000 |
| + VAT @ 4% | 20,000 | + VAT | Nil | + CST @ 2% | 8,000 | + VAT | Nil |
| SP | 5,20,000 | SP | 6,00,000 | SP | 4,08,000 | SP | 12,00,000 |

| Computation of VAT | |
|---|----------|
| Output VAT + CST (20,000 + 8,000) | 28,000 |
| Less : ITC on inputs (50% of 1,25,000 = 62,500) | (62,500) |
| VAT payable / adjustable | (34,500) |

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8

VAT Procedures

Paper Work



REGISTRATION UNDER VAT

Compulsory Registration & Voluntary Registration

- a. A dealer making sale in excess of ₹ 10,00,000 is to get itself compulsorily registered. If do not get itself registered then he is liable for payment of penalty. A dealer whose sale is below ₹ 10,00,000 has the option to get itself registered. No penalty shall be levied if he do not get itself registered. Application for registration is in prescribed form. Every State Govt. has issued different forms for making application for registration.
- b. Following documents are required to be submitted at the time of making application for registration.
- | | |
|------|---|
| i. | Name of the business. |
| ii. | Status of applicant. i.e. Sole proprietor, Partnership Firm or company. |
| iii. | If applicant is partnership firm then details of partners. If company then details of directors / shareholders. |
| iv. | Details of goods which dealer shall sale and purchase. |
| v. | Address of offices and godowns located in that State. |
| vi. | Security if demanded. |
| vii. | Surety of one of registered dealer. |
- c. Commissioner shall verify all documents and records. Inspector may visit the premises before sales tax registration is granted. If Commissioner is satisfied it shall grant registration and issue TIN.

TAX IDENTIFICATION NUMBER (TIN)

- a. There shall be a taxpayer's identification number of 11 digit numerical which will be unique to each dealer.
- b. First two characters will represent the State Code as used by the Union Ministry of Home Affairs. The set-up of the next nine characters may, however, be different in different States.
- c. TIN is being used for identification of dealers in the same way like PAN is used for identification of assessee under Income Tax Act. All the dealers seeking for new registration under VAT or Central Sales Tax will be allotted new TIN as registration number, however every State Commercial Tax Department have made provisions to issue new TIN to their existing dealers replacing old registration / CST number.

CHANGES IN REGISTRATION

| Amendment | Surrender | Cancellation |
|---|--|---|
| Registration can be amended in case of change in address, addition of place of business, addition / deletion in sale / purchase of goods. | A dealer can surrender his registration certificate for cancellation if he ceases to carry on business. He should file returns upto date, pay taxes upto date then apply for cancellation. | Sales tax registration can be suspended or cancelled by sales department if the dealer is found to be engaged in fraud, tax evasion or for non payment of sales tax due. Such cancellation can be done only after issuing SCN, granting personal hearing and issuing adjudication order with reasons. |

IMPORTANCE OF INVOICE

- a. Tax invoice is a very important document. It is a legal document, which shows VAT payable / paid on each transaction. ITC can be availed irrespective of the accounting method followed by the assessee.
- b. A valid tax invoice can be issued only by a registered dealer.



| | | | | |
|----|--|--|------|--|
| c. | A tax invoice is issued in duplicate. The original for the purchaser and the duplicate for selling dealer. Both these invoices shall be preserved by the purchasing dealer and the selling dealer. It shall help in auditing exercise. | | | |
| d. | A valid and proper tax invoice should contain following details then only ITC is available. | | | |
| | i | Name and address of selling dealer. | vii | Quantity |
| | ii | His TIN. | viii | Price |
| | iii | Serial number and date of invoice. | ix | Total value |
| | iv | Full description of goods with details like weight, marking etc. | x | VAT rate & total VAT paid. |
| | v | Declaration as required under State VAT. | xi | Transport details |
| | vi | Signature of authorised person. | xii | The word TAX INVOICE should be mentioned on it prominently. |
| e. | Tax invoice assists in performing audit and investigation activities effectively. It helps in detection of tax evasion. | | | |
| f. | Composite dealer shall issue NON VATABLE invoice. | | | |

RECORDS OF INPUT TAX CREDIT

| | |
|----|--|
| a. | Separate records shall be maintained for invoice on which ITC is available and separate invoice for which ITC is not available. All original invoice should be kept safely. The record should indicate break up of tax paid at different rates, so that tax paid at different rates on inputs can be calculated. |
| b. | If there are purchases from unregistered dealer, the same can be recorded in the main register itself. |
| c. | Monthly totals of credit availed should be taken. |
| d. | Quantity records of all inputs should be maintained separately. |
| e. | Credit is available on VAT tax paid on capital goods also. Since the credit is available in stages, separate records are required. |

RECORDS OF OUTPUT TAX

| | |
|----|--|
| a. | Large Dealer shall maintain sales register with duplicate invoice. |
| b. | Composition dealer shall records daily gross sales. |
| c. | Small dealer is not required to maintain any record. |

ACCOUNTING RECORDS UNDER VAT (NOV 2010 M 4)

| VAT RECORDS TO BE MAINTAINED | | VAT DOCUMENTS TO BE RETAINED | |
|------------------------------|---|------------------------------|--|
| a. | Purchase records. (Quantity and value) | a. | Copies of sale invoices issued with serial number. |
| b. | Sales records. (Quantity and value) (Separate record of any exempt sale) | b. | Copies of all credit and debit notes issued. |
| c. | Record of Inter-State Sales and Inter-State transfer of goods (supported by statutory declarations) | c. | All original purchase invoices. |
| d. | VAT ledger account. | d. | 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. |

PERIOD OF PRESERVATION OF RECORDS : All such records shall be preserved for such period as specified in the respective State Provisions.

PAYMENT OF VAT

VAT is paid either monthly or quarterly.

**RETURN UNDER VAT**

| | |
|----|--|
| a. | Returns are to be filed monthly/quarterly as specified in the State Acts/Rules, and will be accompanied with payment challans. |
| b. | In case of mistakes revised return can be filed. |

ASSESSMENT ON THE BASIS OF RETURN

| | |
|----|--|
| a. | Every return furnished by dealers shall be scrutinised by VAT department expeditiously from the date of filing the return. |
| b. | If any technical mistake is detected on scrutiny, the dealer will be required to pay the deficit appropriately. |

IMPORTANCE OF FILING OF RETURN

| | |
|---|--|
| Filing of returns are designed with a view to | |
| a. | Reduce cost of compliance. |
| b. | Encourage businesses to comply with their obligations; and |
| c. | Ensure efficient processing of data. |

SELF ASSESSMENT OF TAX

| | |
|----|--|
| a. | When a dealer computes correct tax and file upto date return then it is called self assessment tax. |
| b. | Acknowledgement of return is called intimation that return is filed. |
| c. | If the dealer do not self - assess the tax and file a proper return, the Commissioner will assess for that particular tax period. This process is known as default assessment . |

THE ROLE OF THE AUDITOR UNDER THE VAT SYSTEM (MAY 2009, M3)

| | |
|----|---|
| a. | <u>Proper book keeping</u> : the auditor has to ensure the proper maintenance of the records of input credit and its proper utilization for availing the input tax credit. The auditor also ensures the proper accounting of VAT purchases and sales. |
| b. | <u>Tax saving</u> : the auditor has to advise the client to keep the tax invoice copies which is primary documentary evidence for availing the input tax credit and ensure the proper filing within the due dates by incorporating full input tax credit. The auditor also analyses various alternatives to minimize the cost of administrative and accounting system of VAT. |
| c. | <u>Assisting to Departmental Audit</u> : the auditor by virtue of his experience and knowledge has to clarify the audit queries and objections of the departmental audit staff. |
| d. | <u>Certification</u> : the qualified auditor is required to certify the VAT audit reports. |

**AUDIT BY DEPARTMENT - DEFAULT ASSESSMENT
(CROSS CHECKING) (NOV 2012, M4)**

| | |
|----|---|
| a. | A cross-checking is computerised system which works on the basis of coordination between the tax authorities of both the State Governments and the Central Govt. |
| b. | VAT return can be compared with Income Tax return, Excise return or ROC return. |
| c. | This comprehensive cross-checking system will help reduce tax evasion and also lead to significant growth of tax revenue. |
| d. | At the same time, by protecting transparently 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. |
| e. | Where turnover of the registered dealer exceeds ₹ 50 lakhs will have to get their accounts audited by a Chartered Accountant within a period of 9 months from the end of the Financial Year and submit a report of such audit to the department within 28 days of the expiry of 9 months. |

**WHY THERE IS NEED FOR CROSS CHECKING**

| | |
|----|--|
| a. | <u>Operation of the VAT system</u> : VAT = Output tax – Input tax. A collects VAT to those to whom it sells ('output tax'), and pays VAT to those from whom it purchases ('input tax'). It deposits the balance VAT to the Govt. In this way business acts as a tax collector on behalf of the Government. |
| b. | <u>Operation of the fraud</u> : What if the business do not deposit this VAT to the Govt or a purchasing dealer claims ITC on fake invoice. To check this there is need for cross checking. |

DEFICIENCIES IN VAT SYSTEM

| | | |
|----|--|---|
| a. | Non-uniformity in VAT rates across the country | White paper ensured uniform VAT rates across all State. But under VAT regime also States have deviated from the agreed rate structure prescribed by the White Paper to suit their individual requirements. Thus, in the present scenario also, VAT rates are not uniform all over India. |
| b. | Non-uniformity in provisions of VAT laws across the country: | Every State Govt has prescribed their own procedures which are quite different from each other. E.g. Threshold limit of turnover of compulsory VAT audit, compulsory registration, many different forms, availment and utilisation of ITC. |
| c. | CST non-Vatable | Non-availability of credit of central sales tax leads to cascading of taxes. |
| d. | Double taxation | There is no clear distinction between goods and services which leads to double taxation as both Union and State Governments tax the same transaction in different ways i.e., both service and VAT tax are levied on the same transaction. Union Government treats the transaction as service and levies service tax while State Governments treat the transaction as sales and levy State VAT. For instance, cases of deemed sales. |
| e. | Hurdles in movement of inter-state goods | Since, the State-Level VAT is not a National VAT, goods moving from one State to another have to cross through check posts at State borders which causes delays, corruption and harassment. |

Assignment

P1 : What happens to VAT chain when a seller opts for composition scheme? Who are not eligible for composition scheme under the VAT regime? Discuss briefly.

IPCC N 2013

Solution**Consequences to VAT chain if a dealer opts for Composition scheme.**

| | |
|----|---|
| 1. | The dealer will not give input tax credit for his purchases. |
| 2. | The other dealers may not prefer to purchase from this dealer because they will not get input tax credit for those purchases. Cost to consumer is same whether it buys from composition dealer or large dealer. |
| 3. | He will not entitled to issue TAX INVOICE to the buyer. It can issue only Non-Vatable invoice. It shall lead to break in VAT chain. |

Following persons are not eligible for composition scheme.

| | |
|----|---|
| a. | The dealer who is having stock of goods which were brought from outside the State on the day he exercises his option. |
| b. | His taxable turnover exceeds ₹ 50 lakhs. |

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