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Research Paper Accountancy

# VAT & ACCOUNTING

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ABSTRACT

*In the economic reforms of India, indirect tax reforms have become an integral part of the liberalization process since 1991. In the first phase of reforms government of India has been steadily concentrating upon a tax structure that leads to simple, moderate, rational and easy system. At the central level, an initiative has been taken to bring down both the excise and customs tariffs, reduce the number of rates, correct anomalies and get rid of the complexities in the systems. In addition to indirect taxes levied by the centre, states are empowered to levy certain indirect taxes and sales tax, in fact forms major part of revenue for almost all states. There was wide variation in erstwhile sales tax rates of the same commodity in different states. In many states both inputs as well as outputs were taxed creating cascading effect. With a view to removing this shortcoming of erstwhile sales tax systems, perhaps the viable solution found was to shift to destination based Value Added Tax (VAT).*

Keywords :

**INTRODUCTION**

In the economic reforms of India, indirect tax reforms have become an integral part of the liberalization process since 1991. In the first phase of reforms government of India has been steadily concentrating upon a tax structure that leads to simple, moderate, rational and easy system. At the central level, an initiative has been taken to bring down both the excise and customs tariffs, reduce the number of rates, correct anomalies and get rid of the complexities in the systems. In addition to indirect taxes levied by the centre, states are empowered to levy certain indirect taxes and sales tax, in fact forms major part of revenue for almost all states. There was wide variation in erstwhile sales tax rates of the same commodity in different states. In many states both inputs as well as outputs were taxed creating cascading effect. With a view to removing this shortcoming of erstwhile sales tax systems, perhaps the viable solution found was to shift to destination based Value Added Tax (VAT).

**MEANING**

“The value added tax is imposed on the value that a business firms adds to the goods and services that it purchased from other firms. It adds value by processing or handling these purchased items with its own labour force and its own machinery, building or other capital goods. It then sells the resulting product to customers or other firms. The difference between the sales proceeds and the cost of materials etc, that it has purchased from other firms is its value added which is the tax base of the value added tax”.

VAT in essence, tantamount to taxing by installments, the final consumer spending in a domestic economy. It has been considered as a multi-stage tax. Thus, instead of tax being levied on specific list of goods and services, its impact falls on the final consumer goods and services except the goods and services which are specifically exempted. Taxing on VAT basis ensures that each input into the final consumer output is taxed only once. This happens because of the fact that the tax paid on inputs at a previous stage in production is related.

This prevents the cascading effect of taxes. VAT has been explained with reference to both taxable transactions and taxable persons. Taxable transactions are usually defined broadly as sales by persons engaged in industrial and commercial activity. It includes both the sale of goods and rendering of services.

**VAT METHODOLOGY**

The VAT methodology is simple and easy to understand. VAT is most certainly a mare transparent and accurate system of taxation.

Let us assume that A is the primary producer/manufacturer who sells his product to B who is a secondary producer/ manufacturer who again sells or transfer his finished products to C who is a dealer/wholesaler and he sells goods to D, the final customer. Now if A sells goods to B for Rs. 3,000 on which VAT rate is 10 % at each stage of sale/ transfer of goods, B has to pay Rs. 3,300 to A who will pay VAT to the government exchequer. Now suppose, B incurs some amount of expenses in the form of wages, additional raw materials and other manufacturing expenses for completion of production and sells his goods to C, say for Rs.5,500 to B. But B’s actual VAT liability will be only Rs. 200 since out of gross VAT liability of Rs. 500 he will get an input tax credit of Rs. 300 previously borne by him while purchasing from A. Hence, B will pay VAT of Rs. 200 only to the government. Similarly, in case of sale by C to D for Rs. 6,000 C’s net VAT liability will be Rs. 100 only because out of gross VAT liability of Rs. 600 he will get input tax credit of Rs. 500 paid by him earlier to B and for the ultimate consumption by customer D, the VAT liability of D will be Rs. 600 i.e 10 % on Rs. 6,000 the value of goods purchased by him for ultimate consumption. Thus the total VAT of Rs. 600 so generated in the instant case will be borne by the consumer D although collected at Rs. 300, Rs. 200 and Rs. 100 respectively at different points of transfers/sales of Rs. 3,000 Rs. 5000.

| PRIMARY PRODUCER A | |
|---|---|
| Sale of goods to B | Rs. 3,000 |
| VAT payable @ 10 % | Rs. 300 |

| SECONDARY PRODUCER/DEALER B | |
|---|---|
| Input | Rs. 3,000 |
| Addl. Input/or profit | Rs. 2,000 |
| Sales to C | Rs. 5,000 |
| VAT @ 10% | RS. 500 |
| Less: Input Tax Credit | Rs. 300 |
| VAT payable | Rs. 200 |

| SECONDARY PRODUCER/DEALER C | |
|---|---|
| Inputs | Rs. 5,000 |
| Addl. Input and/or profit | Rs. 1000 |
| Sales to D | Rs. 6000 |
| VAT @ 10 % | Rs. 600 |
| Less: input Tax credit | Rs. 500 |
| VAT payable | RS. 100 |

| CUSTOMER D | |
|---|---|
| Gross Value of Purchase | Rs.6,000 |
| Add: VAT @ 10 % | Rs. 600 |
| Total Purchase Price | Rs.6,600 |

| GOVERNMENT |
|---|
| VAT collection = Rs. (300+200+100) |
| = Rs. 600 |
| (Actual borne by the customer) |

**VAT AND BOOKS OF ACCOUNTS**

**A. CREDIT AND DEBIT NOTES**

A VAT dealer is required to issue a credit/debit not drawing nexus to the sale or purchase in any of the following circumstances among others.

- When goods sold or purchased are returned to the supplier or customer
- When an additional discount is offered
- When the sale or purchase price requires an amendment/ change
- When a tax invoice is required to be cancelled for any reason after its issue
- When the tax charged in the invoice exceeds the amounts of tax payable
- When there is a mistake apparent in the invoice necessitating the issue of credit or debit note.

**B. BOOKS AND RECORDS**

Every registered dealer liable to pay tax is required to maintain true and correct accounts in any of the languages notified by the Government for a period of five years (in Karnataka, or as specified in the relevant State Act.) after the end of the year to which they relate. A registered dealer shall maintain commodity-wise stock, purchase and sales accounts. The said accounts (registers) serially numbered shall reflect commodity-wise, quantity-wise and value-wise details of receipt, sales, deliveries, issues and balance. A manufacturer shall maintain production records showing quantity-wise details of various raw materials of component parts/inputs/packing materials and consumables used in such manufacture and the relevant details of the goods so manufactured and the by products/waste products arising thereon.

A works contractor is required to maintain books and records among others indicating the following details:

- Copies of the relevant agreements/contracts together with the particulars of names/addresses of persons on whose behalf he is carrying out the works contract
- The particulars of goods purchased/received and utilized in respect of such works contracts with details of payments received/running bills raised
- The relevant purchase register must contain the details of commodity-wise quantity-wise and value-wise purchases/ receipt and their utilization.

A registered dealer who is engaged in the transfer of right to use goods is required to maintain among others the following books and records:

- Copies of the relevant agreements
- The particulars of names and addresses of the persons to whom he has delivered the goods for use
- The particulars of goods purchased/received and transferred
- The details of payments received / receivable in respect of such agreements/contracts.

Every dealer is required to maintain the books and records/ documents indicated above together with tax invoices/sales bills/debit & credit notes relating to his business till the retention period specified in the respective State Acts. In the event the said dealer maintain in an electronically readable format. In case, such books are maintained electronically the dealer is required to maintain copies of such registers duly printed in the manner prescribed under the respective Acts/Rules.

**ACCOUNTING SYSTEMS**

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

**GUIDANCE NOTE ON ACCOUN TING FOR STATE-LEVEL VAT**

Institute of Chartered Accountants of India' guidance note on accounting for State level VAT is very apt and timely. Since the guidance not is based on the White Paper, dealers have to fine-tune the accounting entries according to provisions of each state VAT law/rules.