CREDIT SYSTEM

BACKGROUND OF VAT

Meaning:

Value Added Tax is a **taxation system** under which **multistage tax** (i.e collected at each stage) levied on the value addition *(i.e Sale – purchase; wages + other costs)*. Under VAT system tax is charged on Sale value of goods.

ORIGIN/DESTINATION PRINCIPLE:

- **ORIGIN PRINCIPLE:** Under origin principle value added domestically on goods whether they are meant for export or consumed domestically is subjected to tax. So this principle taxes export hence generally not followed.
- **DESTINATION PRINCIPLE:** Under this principle goods are taxed if consumed in the country. So this principle taxes imports and not exports hence followed by majority.

Background of VAT – World Scenario:

- **France** was the first country to adopt VAT in **1954.**
- However a **full- fledged VAT was introduced in Brazil in the mid 1960's.**

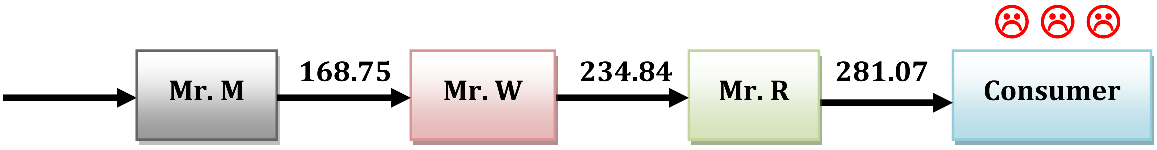
Introduction of VAT in India

VAT system was first introduced in India at Central Level called Modified Value Added Tax (MODVAT) covering only excise.

- **VAT system was first introduced in India in the year 2005. Haryana was the first state to adopt VAT in India (2003) and UP was the last state.**

CASCADING EFFECT ANALYSIS

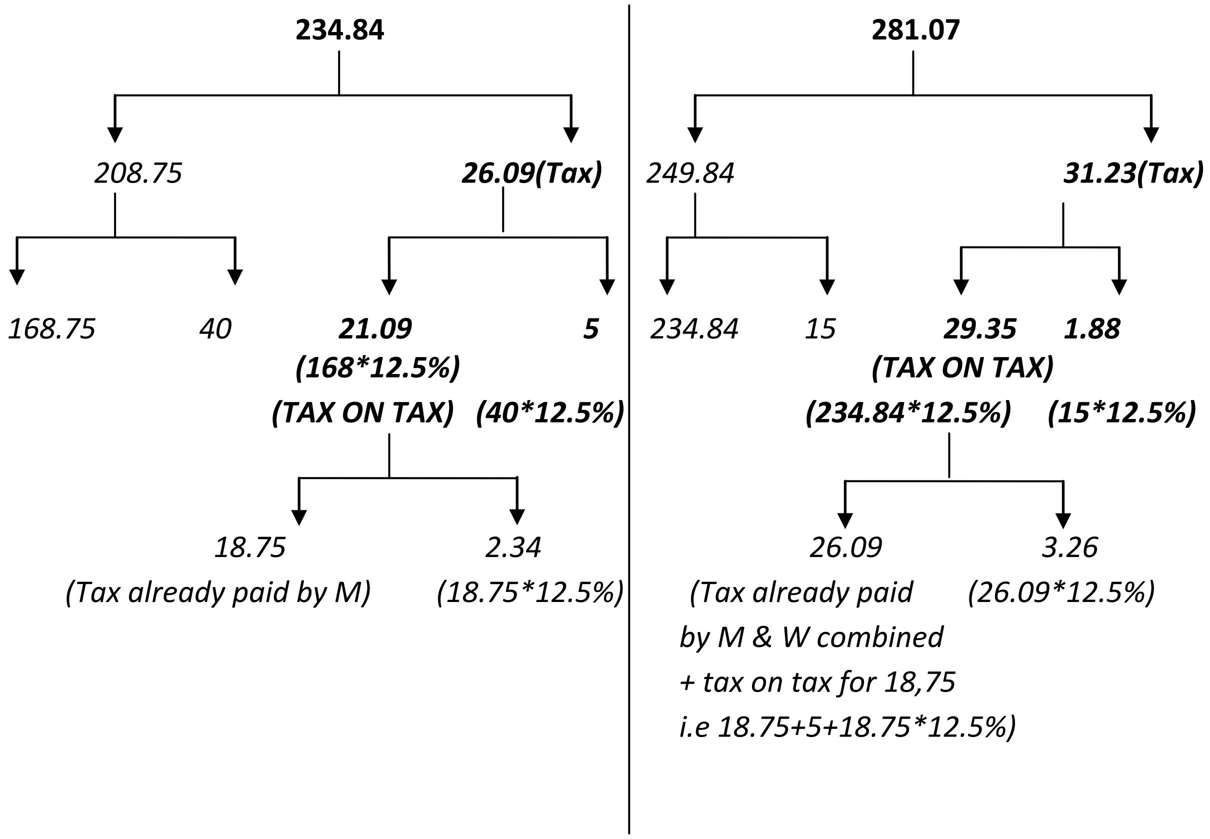
(1) HISTORICAL SALES TAX METHOD



Purchase Price	-	168.75	234.84	
(+) Raw Material	100	-	-	
(+) Labour	20	-	-	
(+) Overhead	10	20	5	
(+) profit	20	20	10	281.0
Total	**150**	**208.75**	**249.84**	
(+) Sales Tax 12.5%	18.75	26.09	31.23	
Sale price	**168.75**	**234.84**	**281.07**	

ANALYSIS:

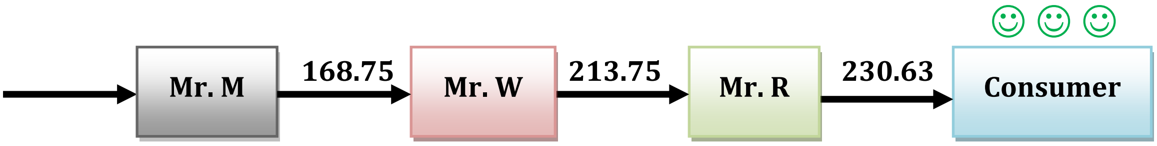
Let us now analyze the above two prices – ₹234.84 and ₹281.07



Sales tax is on sales and not on tax portion. So extra tax paid due to tax on tax = 21.09+29.35 = 50.44. This Tax on tax is the cascading effect, which ultimately increases the cost in the hands of consumer.

CASCADING EFFECT ANALYSIS

(2) VAT METHODS- INVOICE SYSTEM



Purchase Price	-	168.75	213.75	
Less: Input Tax credit	-	18.75	23.75	
TOTAL	-	150	190	
(+) Raw Material	100	-	-	230.5
(+) Labour	20	-	-	
(+) Overhead	10	20	5	
(+) profit	20	20	10	
TOTAL	**150**	**190**	**205**	
(+) Sales Tax 12.5%	18.75	23.75	25.63	
Sale price	**168.75**	**213.75**	**230.63**	

Difference in prices under two system

= 281.07 – 230.63

= ₹ 50.44 (same as excess sales tax due to tax on tax – cascading effect under historical method)

VARIANTS OF VAT

GROSS PRODUCT VARIANT:

VAT Credit

Raw Material - **100%**

Capital Goods - **NIL**

INCOME VARIANT:

VAT Credit

Raw Material - **100%**

Capital Goods - **allowed in Installments (Max 36 months)**

CONSUMPTION VARIANT:

VAT Credit

Raw Material - **100%**

Capital Goods - **100%**

Utilization of Credit/Set off

Tax paid on Purchases	Tax to be paid on Sale	Credit of tax paid can be utilised for paying VAT on sales?
VAT	VAT	Yes
VAT	CST	Yes
CST	VAT	NO

ZERO RATING

There is significant difference between "A sale being exempted from tax" and "a sale being zero rated. The similarity is that in both cases no tax is payable for the sale. But in respect of zero rating, the taxes paid earlier on the purchases made are allowed as ITC to the seller. No ITC is allowed in case of exempt goods.

Zero rating means freeing the product from the tax burden of both input as well as output. On the contrary exempting the product means the product gets freed from the tax burden of final product (output) only.

ST SE GST TAK

BACKGROUND

Service Tax in India was **introduced in 1994** upon the recommendation made by **Chelliah Committee** on Tax Reforms headed by **Dr. Raja J. Chelliah**. The then Finance Minister Dr. Manmohan Singh in his budget speech for the period 1994-1995, for the first time coined the applicability of Service Tax in India. In his speech FM Singh said:

"'There is no sound reason for exempting services from taxation, when goods are taxed and many countries treat goods and services alike for tax purposes. The Tax Reforms Committee has also recommended imposition of tax on services as a measure for broadening the base of indirect taxes. I, therefore, propose to make a modest effort in this direction by imposing a tax on services of Telephones, Non-life insurance and Stock brokers."

So the journey of taxation of services began by selective taxation of just three services on July 1, 1994. Before Budget 2012, 119 services were brought to the service tax net (Selective Approach). However Budget 2012 brought a paradigm shift in the history of Service by shifting the service tax base from selective approach to comprehensive approach by introducing the concept of negative list. Presently all the services except 15 services are under Service Tax ambit.